

MOBILIZING SOCIAL BUSINESS TO ACCELERATE MDGs ACHIEVEMENT IN TIMOR-LESTE



Timor-Leste
2014-2015

Access to Finance Consultancy Report

This report analyses the supply and demand of small and medium enterprises financing in Timor-Leste. It researches programmes for improving finance for social businesses, and concludes by recommending a loan guarantee as the ideal format for the Social Business Fund to operate in Timor-Leste.

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Empowered lives.
Resilient nations.



This report was produced for UNDP Timor-Leste as part of the project
Mobilizing Social Business to Accelerate MDGs Achievement –
Access to Finance

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MOBILIZING SOCIAL BUSINESS TO ACCELERATE MDGs ACHIEVEMENT IN TIMOR-LESTE

ACCESS TO FINANCE CONSULTANCY REPORT

EXECUTIVE SUMMARY

The ‘Mobilizing Social Business’ project aims to promote Small and Medium Enterprises (SMEs) as engines of inclusive economic growth. The project is a collaboration between the Timor-Leste Government and UNDP focusing on Social Business (SB) promotion as a sustainable way to achieve social returns with financial sustainability, poverty reduction towards the Millennium Development Goals (MDGs), employment opportunities and income generation, and private sector development.

In the conceptual phase of “Mobilizing Social Business to Accelerate MDGs Achievement”, access to finance was identified as one of the main challenges for entrepreneurs to start their business in Timor-Leste. This consultancy collected and analysed data about demand and supply of loans to SMEs in Timor-Leste, and recommends mechanisms to provide finance for social enterprises.

For the supply analysis, banks, microfinance institutions and government agencies with private sector development activities shared the details of their programs and credit products available to SME. Banks and microfinance institutions do offer credit to SMEs that can provide credit history and collaterals, but these requirements exclude most entrepreneurs (current and future). Government programmes target microbusinesses (except MCI, which has a grants programme to large investments) in specific activities or geographic locations, and capital provided is limited. In summary, most SMEs do not have access to credit.

EXECUTIVE SUMMARY (CONT.)

On the demand side, the census data and business data available show that Timor-Leste has a low ratio of micro, small and medium enterprises (MSME) to 1000 people when compared to other countries, making the case for SME promotion. Regarding employment, only 29% of the population is economically active (or 49.3% of the population aged 15 years old and over). Among the employed population, 66% are classified as in vulnerable employment (with no or limited employment benefits and no stable income). Promotion of SMEs could create many jobs.

During this consultancy we also conducted focus group discussions (public consultations) in all 13 municipalities to collect primary data about SME challenges and access to finance from two participant profiles: future entrepreneurs and current entrepreneurs. The Chamber of Commerce and Industry of Timor-Leste helped organize these focus groups discussions.

This report discusses and evaluates mechanisms to facilitate SME access to finance (grants, leasing, loan guarantees, and bank loans), recommending a loan guarantee scheme. Historical records highlight high credit losses as a major threat to the Social Business Fund sustainability, but there are alternatives to reduce credit risk, for example requiring flexible guarantees (part of the business ownership, its assets, or even a additional guarantor).

The Banco Nacional de Comércio Timor-Leste (BNCTL) is willing to further discuss a major participation in the project, offering soft-loans to viable business plans presented by skilled entrepreneurs. Once SME soft-loans are developed, it can become a standard product for the bank (not restricted to this project) and be used in other government projects and even to replace some of the grant programmes.

In order to improve SME environment in the country, increasing access to finance is essential, but improving business plans and entrepreneur skills is also critical. Hence it is recommended that this project invests in improving SME access to finance and in training and coaching entrepreneurs – to increase entrepreneurs' chances of launching and expanding businesses successfully. I.e., just handing out money will not work.

TABLE OF CONTENT

EXECUTIVE SUMMARY	3
1. SUPPLY ANALYSIS	7
1.1. Financial Service Providers	9
1.2. Government & Agencies Programmes	19
1.3. Summary	33
1.4. Comparative Analysis	38
2. DEMAND ANALYSIS	43
2.1. Surveys and Reports	45
2.2. District Consultation	51
2.3. Business Plan Competitions	75
2.4. Key Findings & Recommendations	79
3. FUND ADMINISTRATIVE ARRANGEMENTS	83
3.1. Benchmarking of Social Business Funds	85
3.2. Social Businesses in Timor-Leste	95
4.3. Social Business Fund Design	98
5.4. Sustainability Strategy	114
4. FINAL RECOMMENDATIONS	117

1. SUPPLY ANALYSIS

Evaluation of current financing practices & grants programmes for private sector development

Section Content

1.1. Financial Services Providers

1.2. Government Agencies

1.3. Summary

1.4. Comparative Analysis

SUPPLY ANALYSIS: KEY PLAYERS

Key players in the financial sector were interviewed about their credit products and procedures in order to evaluate the supply of credit to entrepreneurs in Timor-Leste. The summary of products offered are detailed in the following pages, based on the interviews done during first half of 2014.

Credit cooperatives and Savings Groups are an important channel to individual finance and to serve micro businesses. In this analysis credit cooperative and savings groups were not consulted, due to the relatively small amounts of the loans they offer.

Government ministries and agencies maintain programmes for private sector development, that may include grants for business improvement. An overview of these programmes are included in this report. The report also include information from DFAT, NZAID and USAID.

Financial Services Providers	Programmes for Private Sector Development
<p>Commercial Banks</p> <ul style="list-style-type: none">• ANZ• BNU• BNCTL• Mandiri <p>Microfinance Institutions</p> <ul style="list-style-type: none">• Moris Rasik• Tuba Rai Metin	<p>Government</p> <ul style="list-style-type: none">• Ministries• SEFOPE• SEM• SEAPRI <p>Development Partners Programmes</p>

1.1. FINANCIAL SERVICES PROVIDERS

Commercial Banks & Microfinance Institutions

COMMERCIAL BANKS CREDIT PRODUCTS: **BNCTL** BANCO NACIONAL DE COMÉRCIO DE TIMOR - LESTE

Banco Nacional de Comércio de Timor-Leste (BNCTL), previously Institute of Microfinance of Timor-Leste (IMfTL), became a bank in 2011, fully owned by the government. Today it is present in all 13 municipalities, offering microfinance products (group loans for rural and urban poor Timorese) while expanding its products to attend larger and more sophisticated clients. BNCTL credit products for SMEs are detailed in the table below:

	Group Loan	Market Vendor Loan	Agricultural Loan/ Seasonal Loan	Multi-purpose loan	Business / Investments Loan	Project Loan (*)
Max. Loan Value	\$1,000	\$1,000	\$2,000	Instalment lower than 50% of salary	Unlimited	Up to 50% of the project amount
Loan Tenure	6 months	6 months	9 months	2 to 5 years	2 to 3 years or longer	1 year
Interest Rate per year	12% p.a.	12% p.a.	14% p.a.	14% p.a.	8 to 14% p.a.	8 to 14% p.a.
Administrative Cost	2% of the loan amount	2% of the loan amount	2% of the loan amount	2% of the loan amount	2% of the loan amount	2% of the loan amount
Grace Period	No	No	Interest paid monthly; principal can be paid at the end	No	Interest paid monthly, principal can be negotiable (max. 1 year)	No
Collateral / Comments	No collateral, mutual guarantee 4 to 8 members	No guarantee required	Assets of the borrowers	Employed with salary paid in BNCTL, 2 guarantors also with salaries paid in BNCTL	120% of the total loan amount	120% of the total loan amount

BNCTL also offers a “Payroll Loan” as personal loans. It is limited to 14 salaries, 36 months as maximum loan period, no grace period, at 18% p.a. and 2% administration fee.

(*) Government Additional \$10Million: Focus on Medium and Large companies for private and government projects, and investments

4 Products: Construction (short term to 1 year – disbursement based on the project phases); Investments (hotel etc.), Investments in agriculture (coffee...), Housing Loans with developers (mortgages for up to 25 years) – Plan to launch product for construction July 2014, and other types in 2015. Partnership with IADE, to offer training on how to make an investment proposal

Updated prices and details available at: <http://bnctl.com/> (Operations / Loans)

COMMERCIAL BANKS CREDIT PRODUCTS:



BNU was the first bank to operate in Timor-Leste, in 1912. BNU is part of the Portuguese Grupo Caixa Geral de Depósitos. Today it is present in 12 municipalities with 14 branches, it offers a wide range of financial products to individuals and organizations.

BNU credit products for SMEs are detailed in the table below:

	Trade Loan	Loan backed by Government contracts	Credit for Treasury	Credit for Investments
Specific product	Caucionada and Renda Fixa Tesouraria	Geral Tesouraria	Renda Fixa Reestruturação	Renda Fixa and Geral Investimento
Max. Loan Value	Based on the client's risk assessment	% of the contract, based on project total cost	Based on the client's risk assessment	% of the project investment
Loan Tenure	18 months	18 months	120 months	84 months
Interest Rate per year	5% (with collateral) to \pm 11.5% (no collateral)	5% (with collateral) to \pm 11.8% (no collateral)	5% (with collateral) to \pm 13% (no collateral)	5% (with collateral) to \pm 11.5% (no collateral)
Evaluation Fee	\$350 to 0.75%	\$350 to 0.75%	\$350 to 0.75%	\$350 to 0.75%
Credit Initiation Fee	3% or 1.5% with collateral	3% or 1.5% with collateral	3% or 1.5% with collateral	3% or 1.5% with collateral
Grace Period		Based on the project		Based on the project
Collateral / Guarantees	Bank domicile for receivables, account balances, fixed assets, owners' personal assets	Contract has to mention that government payments will be done at BNU	Bank domicile for receivables, account balances, fixed assets, owners' personal assets	Bank domicile for receivables, account balances, fixed assets, owners' personal assets

Key Insights for Credit Assessment:

- There is no standard accounting for financial reports to support the risk assessments
- Loans for new businesses/start ups are only approved when the client has a good history in BNU and is able to present a viable business plan
- Loans applications are refused mostly due to the client's inability to provide guarantees for loans

Updated prices and details available at: <http://www.bnu.tl/Precario/Documents/PRECARIO.pdf>

COMMERCIAL BANKS CREDIT PRODUCTS:



ANZ is part of Australia and New Zealand Banking Group, and is operating in Timor-Leste since 2001. ANZ Timor-Leste has one branch that offers comprehensive products and services for individuals as well as small businesses.

ANZ credit products for SMEs are detailed in the table below:





	Trade Loan	Loan backed by Government Contracts	Loans for Private Projects	Revolving
Specific product	Letter of Credit	Overdraft facility	Loans for Projects	Revolving facility
Loan Tenure	2 to 3 months	Same as the contract	Up to 4 years	1 to 3 years
Interest Rate per year	11.75% (+ - 3%)	11.75% (+ - 3%)	11.75% (+ - 3%)	11.75% (+ - 3%)
Grace Period			Up to 6 months	
Collateral	Client Assets	Client Assets	Client Assets	Client Assets
Comments		Difficult to monitor the progress / value spent	Credit line used based on the project schedule, ANZ lends part of the total investment needed	

Key Insights:

- Maximum loan value is defined by each client's risk assessment and their capacity to pay
- Other products:
 - Bank's guarantee to secure government contracts;
 - Agreements with ANZ from other countries to facilitate transfers from clients that want to invest in Timor-Leste
 - Unsecure loans for personal accounts (18% for max 60 months): portfolio of \$2M (~300 clients)
- ANZ has an agreement with INFUSE and TRM (a loan line was approved for Tuba Rai Metin operations, and as a amounted in deposited in the banks as guarantee: interest rates 5% to 7%)
- ANZ's loan portfolio: Trade Finance \$11M (~10 clients), Commercial & Corporate: \$35M (~40 clients), Unsecure loans for personal accounts \$2M (~300 clients)

COMMERCIAL BANKS: CREDIT PRODUCTS FOR SMES

The table below shows the SMEs credit products details from all commercial banks operating in Timor-Leste:

				
Specific product	Business Loans	Business Loans	None for SMEs	Loans for Private Investment
Max. Loan Value	Unlimited	Based on the risk assessment		Based on the risk assessment
Loan Tenure	Up to 5 yrs.	Up to 10 yrs.		Up to 4 yrs.
Interest Rate per year	8 to 14%	11.5% to 13% (based on LIBOR)	3% to 11%	8.75% to 14.75%
Insurance	No	No		No
Admin. Fee	2%	No (TBC)		No (TBC)
Grace Period	No	Based on project		Up to 6 months
Collateral	Assets from borrowers	Assets, bank domicile		Assets, bank domicile
Comments	Active loans accounts: 2,558 Recently launched the "Loan for Project"	Write-off rates for the old portfolio with up to 50%. Clients with good history in the bank, present financial reports, prove the capacity to pay back	Bank has a limited number of loan accounts, mostly for companies with construction contract with government. Also for clients doing business in Indonesia and Timor-Leste	Very selective, client with good history and proven income /assets to pay back the loan. Around 50 active business loan (personal loans: 300)

Note: Mandiri is currently revising its credit policies and products. The credit team has 3 staff that are working with Mandiri head office in Jakarta to expand the bank's credit products in Timor-Leste.

MFI: SME CREDIT PRODUCTS

There are two MFIs operating in Timor-Leste focused on group loans. Recently they started to offer larger loans to SMEs, as detailed below. MFIs serve clients outside of main cities, reaching rural villages covering most of the country. During the survey period both of them were applying for the “Other Deposit-Taking Institutions”, as required by the Central Bank, due to the increasing volume of deposits they collect.



Tuba Rai Metin

Specific product	SME Loan	SME Loan - TRM 3
Max. Loan Value	\$25,000	\$10,000
Loan Tenure	Up to 3 yrs.	Up to 2 yrs.
Interest Rate (*)	15% per year over the total loan amount around 30% effective interest rate	1.5% per month over the total loan amount 30% to 36% effective interest rate
Insurance	Mandatory: 2% of loan	Mandatory: 1.25% per year
Admin. Fee	1%	2%
Grace Period	No	Up to 2 months
Collateral	Movable assets, and land certificate	Proven cash flow to serve the loan.
Comments	No need to be registered business. Cannot be a start up, only for business expansion. Plan to increase focus on this product (78 accts)	No need to be registered bus. (has to be visible). Cannot be a start up, only for business expansion, can be a new client



Note: After the election of new management in 2014, the Chamber of Commerce Timor-Leste (CCI-TL) declared its intention to create a new MFI to support entrepreneurs

MFI INTEREST RATES: EFFECTIVE VS. “FLAT”

Both MFIs inform their interest rate as “flat”, meaning the interest paid every month is calculated based on the total loan amount instead of the outstanding balance. The calculations of effective interest rates based on the loan instalments leads to the double of the informed “flat” interest rate. Calculation details are shown below:

Loan Amount 25,000.00 US\$
 Repayment Period 12 Months
 Interest rate 15% per year

"Flat" Interest Rate Calculation					
Month	Installments Payment			Outstanding Balance	Interest Rate p.a.
	Principal	Interest	Total		
M 0				25,000.00	
M 1	2,083.70	312.50	2,396.20	22,916.30	15%
M 2	2,083.30	312.50	2,395.80	20,833.00	16%
M 3	2,083.30	312.50	2,395.80	18,749.70	18%
M 4	2,083.30	312.50	2,395.80	16,666.40	20%
M 5	2,083.30	312.50	2,395.80	14,583.10	23%
M 6	2,083.30	312.50	2,395.80	12,499.80	26%
M 7	2,083.30	312.50	2,395.80	10,416.50	30%
M 8	2,083.30	312.50	2,395.80	8,333.20	36%
M 9	2,083.30	312.50	2,395.80	6,249.90	45%
M 10	2,083.30	312.50	2,395.80	4,166.60	60%
M 11	2,083.30	312.50	2,395.80	2,083.30	90%
M 12	2,083.30	312.50	2,395.80	-	180%
Total Interest Paid		3,750.00			30.16%
<i>Calculation:</i>	$\frac{\text{Loan amount / Repayment Period}}{\text{Loan Amount} / 12}$	$\frac{(\text{Interest Rate} * \text{Loan Amount}) / 12}{\text{Loan Amount} / 12}$	$\frac{\text{Principal} + \text{Interest}}{\text{Loan Amount} / 12}$	$\frac{(\text{Outstanding Balance M-1}) - \text{Payment of Principal}}{\text{Outstanding Balance M-1}}$	$\frac{(\text{Interest} * 12)}{(\text{Outstanding Balance M-1})}$

To simplify the calculation, it does not consider insurance and administrative fee payment.

“Flat” interest rate calculation:

MFIs calculate the interest to be paid every month multiplying the interest rate by the total loan amount instead of the outstanding balance.

Hence the interest to be paid is the same every month (thus the name “flat”) during the loan, despite the reduced outstanding balance, but the calculated effective interest rate increases over the period of the loan.

Calculating the effective interest rate based on the instalments, the rate is **30.16% per year**.

Moris Rasik informs its interest rate on a per year basis, and Tuba Rai Metin on a per month basis.

MFI INTEREST RATES: EFFECTIVE VS. "FLAT"

Effective interest rate calculation:

This is the international standard to calculate interests, and is used by the local commercial banks.

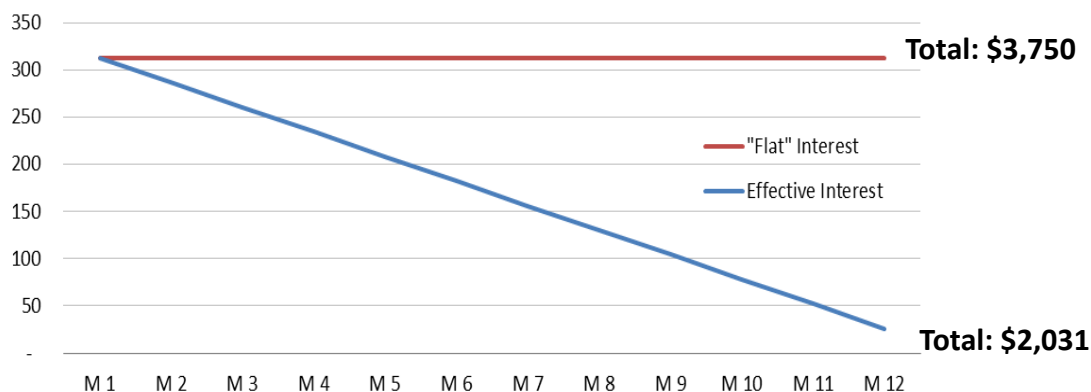
Interest to be paid is calculated over the outstanding balance, so the interest amount declines over the loan period, but the effective interest rate is constant.

Loan Amount 25,000.00 US\$
 Repayment Period 12 Months
 Interest rate 15% per year

Effective Interest Rate Calculation					
Month	Installments Payment			Outstanding Balance	Interest Rate p.a.
	Principal	Interest	Total		
M 0				25,000.00	
M 1	2,083.33	312.50	2,395.83	22,916.67	15%
M 2	2,083.33	286.46	2,369.79	20,833.33	15%
M 3	2,083.33	260.42	2,343.75	18,750.00	15%
M 4	2,083.33	234.38	2,317.71	16,666.67	15%
M 5	2,083.33	208.33	2,291.67	14,583.33	15%
M 6	2,083.33	182.29	2,265.63	12,500.00	15%
M 7	2,083.33	156.25	2,239.58	10,416.67	15%
M 8	2,083.33	130.21	2,213.54	8,333.33	15%
M 9	2,083.33	104.17	2,187.50	6,250.00	15%
M 10	2,083.33	78.13	2,161.46	4,166.67	15%
M 11	2,083.33	52.08	2,135.42	2,083.33	15%
M 12	2,083.33	26.04	2,109.38	-	15%
Total Interest Paid		2,031.25			

Calculation:	$\frac{\text{Loan amount /}}{\text{Repayment Period}}$	$\frac{(\text{Interest Rate} * \text{Outstanding Balance M-1})}{12}$ <i>M-1 = Previous Month</i>	Principal + Interest	$\frac{(\text{Outstanding Balance M-1}) - \text{Payment of Principal}}{\text{Interest}}$	$\frac{(\text{Interest} * 12)}{(\text{Outstanding Balance M-1})}$
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Loan Interest: Effective Rate vs. "Flat" Rate



CREDIT UNIONS & SAVINGS GROUP



There are around **76 Credit Unions (CUs)** operating in Timor-Leste with more than **8,700 members**. CUs are coordinated by Federação Hanai Malu and supported by MCIA and the Credit Union Foundation Australia (CUFA).

MCIA supports CU's through: capacity building, technical assistance, office furniture and equipment, and auditing.

CUs play a key role to widespread basic financial practices: members are required to contribute to the CU administration and save small amounts monthly; they can also get loans at variable rates and conditions. **Interest rates can be as low as 3%, and USD 5,000** is the maximum loan amount at large CUs.



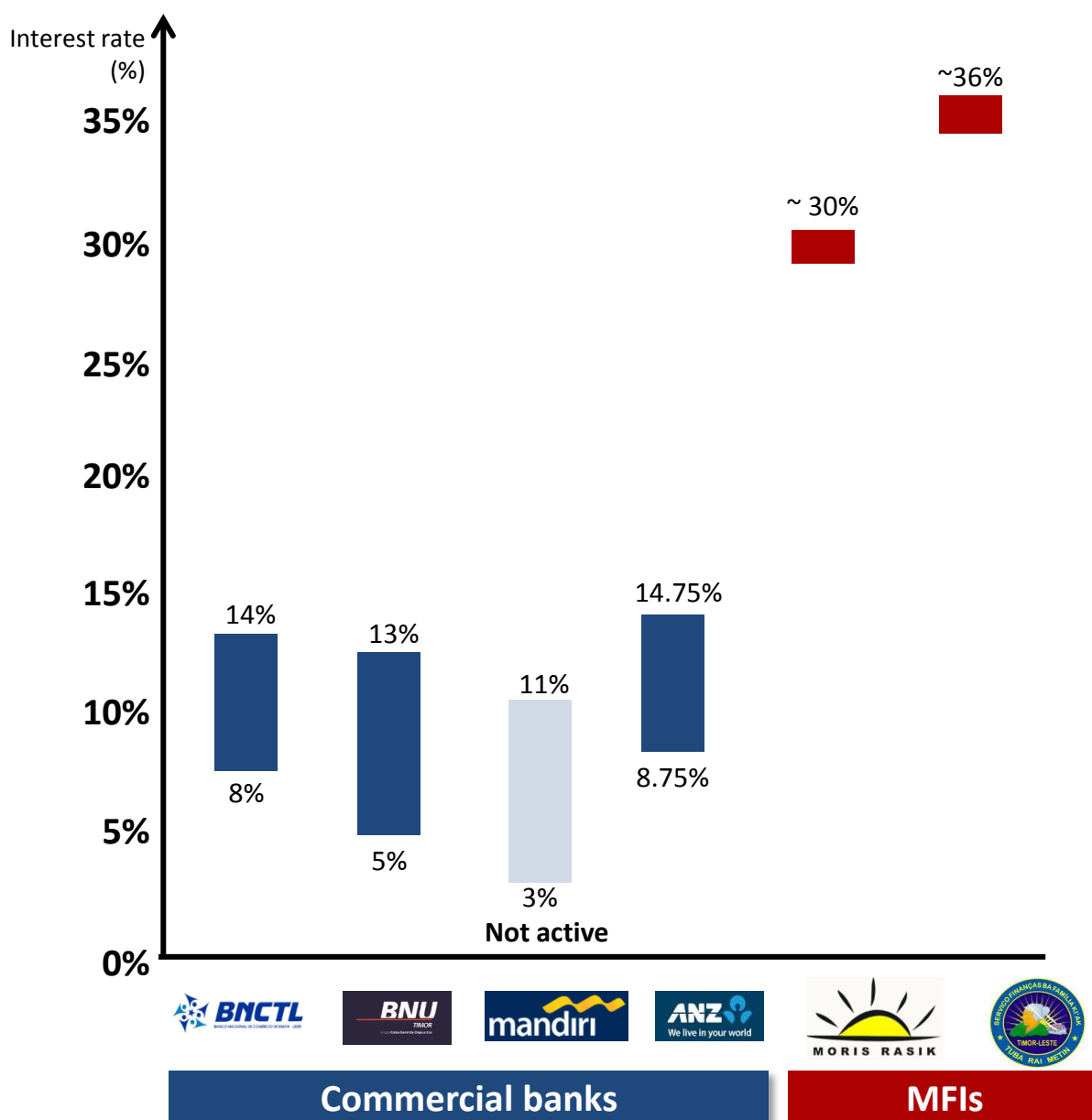
Savings Groups (SGs) are present in **9 municipalities** of Timor-Leste, and concentrated in **Oecussi (60% of 5,600 SGs' members) and Ermera municipalities (11%)**. SGs offer savings and loans to their members. Maximum loan amounts are small.

Sources: Credit Union information from MCIA, data as of Jan 2015

SUMMARY: COMPARING EFFECTIVE INTEREST RATES

Including a guarantor can significantly lower the interest rates banks charge for loans, as it reduces the credit risk. Currently, Mandiri does not provide credit to Timorese clients, except for clients that also maintain an account with Mandiri Indonesia.

MFI inform “flat” interest rates for their loans, which is quite misleading



1.2. GOVERNMENT PROGRAMMES

MINISTRY OF COMMERCE, INDUSTRY AND ENVIRONMENT (MCIA)

MCIA has a grant programme that aims to promote private sector, the “Fundus Subvensaun Públika”. This programme is managed by different National Directorates based on their mandate, as shown in the table below:

Areas	Environment	Cooperatives & Micro Enterprises	Industry	Commerce	Large Projects
2014 Budget	\$271,000	\$1,000,000	\$600,000	\$170,000	\$1,159,000
2015 Budget	\$270,000	\$1,000,000	\$600,000	\$250,000	\$1,880,000
Focus on	Environmental and Social Impact	Development of community economy	Improve industries activities	Benefits to communities and diversity of activities (started in 2014)	Mobilising large groups of beneficiaries

Fundus Subvensaun Públika

- Business grants directly transferred to beneficiaries, based on proposals related to cooperatives, environmental, industrial and commercial activities
- It aims to promote: economic activities, community participation in the economy, job creation/self-employment, and sustainable development in coordination with local authorities
- Monitoring & Evaluation: conducted by the technical team a year after the support is granted, based on the situation and perceived necessity. Projects well evaluated can apply for additional grants (additional grant proposal will undergo evaluation – not guaranteed)

MINISTRY OF COMMERCE, INDUSTRY AND ENVIRONMENT (MCIA)

Criteria (*):

- Registered businesses that are licensed and operating
- Only for businesses with physical structure (place to operate)
- Groups or individual business owner can apply

Process:

- Write a proposal and submit with copy of documents (business licenses, identity card, etc.)
- Approval letter from local authority (Suku/Village Chief)
- Site check
- MCIA receives proposals all year round. For cooperatives and micro-

enterprises the process is concentrated in 1st semester

- Proposals are evaluated by related directorate in MCIA
- Selected proposal on commerce, industry, cooperatives and micro enterprises can receive up to \$10,000, based on the project and size of the enterprise
- Larger projects can receive larger grants, normally divided in two transfers:
 - 40% at the beginning of the project
 - 60% after evaluation of reports about initial investments and activities

- MCIA receives proposals for micro and small businesses support during the whole year
- Based on the requests and ministry priorities, each directory decides the proposals they will support
- Currently there is no standard process across the directories for collection, analysis and criteria to evaluate the grants proposals. There is a plan to standardize the processes across the ministry
- Evaluating a project to replace current subsidies by incentive programme

(*) The report includes only main criteria for grant application. Criteria for grant application are constantly updated, and each directorate defines additional criteria. Please consult MCIA directly for updated process, forms and criteria.

MINISTRY OF AGRICULTURE, FISHERIES AND FORESTS (MAFF)

MAFF conducts a few programmes to improve national agriculture production; its grants programmes are detailed below:

- Main objective:
 - Improve quality and productivity of crops
 - Create jobs in rural areas
 - Replace the traditional agriculture methods with advanced technology and technical skills
- Provides machinery, seeds, technical assistance, material for selected groups, or grants
- 2014 Budget: \$500,000 (\$3,000 to \$5,000 per group)
- More than 1,000 proposals received per year
- Monitoring & Evaluation: MAFF staff verifies if the groups are sharing the profits, and all members are benefiting from the activities (unsuccessful groups normally misuse the grant)
- Planning to start microcredit with low interest rates

Criteria:

- Groups of around 10 members (proof of group establishment)
- MAFF staff identifies the key areas and groups from each community
- Priority to remote areas
- Suku head endorsement
- No matching funding necessary

Process:

- MAFF application forms (send directly to MAFF or to the Suku CDCA)
- Proposal submitted during the year for implementation in the following year
- Committee evaluates the proposals
- If approved, groups receive 40% of the total support in the 1st phase; if successful, they received the remaining 60%
- One-time support, no repetition

MINISTRY OF AGRICULTURE, FISHERIES AND FORESTS (MAFF)

Other programmes conducted by MAFF that contribute to private sector development are:

Community Development Centres for Agriculture (CDCA)

- Investment to build CDCAs in each Suku (42 already implemented)
- Provide information regarding access to market, fertilizers, seeds varieties, etc.

Partners Coordination

Each partner has its area/forms of intervention related to agriculture coordinated by MAFF committee, example AUSAID (Seeds of Life), GIZ (training), USAID (technical support), JICA (coffee rehabilitation, technical support for “Produtu Ida, Suku Ida” programme, rehabilitation and irrigation for rice cultivation), SEFOPE (equipment)

“Produtu Ida, Suku Ida” Programme

- Objective is to improve the quality and productivity of groups already producing good quality products. It also aims to create incentives for smaller groups in the same suku to become potential partners or suppliers
- Enforce existing economic activities in the field, offering:
 - Material, training and transport
 - Technical assistance to improve quality and productivity
 - Access to markets
- Groups are identified and selected based on the quality of products they produce
- Currently the programme supports more than 20 groups with ± US\$2,000/year/group
 - E.g., Honey production from Manatuto, support with proper packaging (bottle and labels)

MINISTRY OF TOURISM

The Ministry of Tourism (MoT) grants programme is focused on the promotion of community tourism. The details of the programme are:

- Programme started in 2013
- Provides grants for investment proposals to expand community tourism businesses. Business must be operating and registered
- Currently the priority districts are: Aileu (to celebrate the anniversary of unilateral independence proclamation in 2014) and Oecussi (500 years since the arrival of Portuguese colonisers in 2015)
- 2014 Budget: \$200,000 (around \$5,000 per proposal)
- Specific skills training is offered for associations and groups

Criteria:

- Groups or individuals
- Areas: guesthouses, restaurants
- Priority districts for MoT
- Good performance business (already operating)
- Submit an investment proposal
- MoT staff visits to evaluate the business
- No matching funding required

Process:

- Proposals submission in February and March (200 proposals received in 2014)
- Proposal evaluation from April to July – final decision by the Minister
- Result available in Aug/Sep (65 proposals supported in 2013)
- Not selected projects stay in the database for potential future selection

SECRETARY OF STATE FOR THE SUPPORT AND PROMOTION OF THE PRIVATE SECTOR (SEAPRI)

This Secretary was extinguished in 2015.

SEAPRI did not directly manage a grants programme; it was responsible for proposing policy and establishing mechanisms for private sector promotion through its agencies:

1. Investment Specialized Agency: Promotion of large investments through investment certificates (tax incentives), and support for loans of up to 50% of total investments
2. Bamboo Centre: Initiative for bamboo furniture production, and promotion of bamboo cultivation in specific areas
3. National Commercial Bank of Timor-Leste (BNCTL)
4. Institute for Business Development Support (IADE)

Key Activities:

- Foment financial inclusion in rural and urban areas
- Facilitate government transfer programmes
- Offer special funds from the government for private sector promotion
- Provide full range of services to individuals and enterprises, including micro loans

Key Activities:

- Training centres, focus on developing business skills
- Present in the districts: Centro de Desenvolvimento Empresarial (CDE)
- Share information about government procurement notices and procedures
- Organizing business plan competition
- Mentoring and business consulting
- Seed capital for business incubator

SECRETARY OF STATE FOR PROFESSIONAL TRAINING AND EMPLOYMENT (SEFOPE)

In addition to professional trainings, SEFOPE maintains a programme for the “Promotion of Self-Employment”. The programme aim to support to SEFOPE graduate students who have not found a job and want to start a small business.

Currently the programme is under revision to include people with 2 to 5 years of experience who have not attended SEFOPE trainings.

The “Promotion of Self-Employment” Programme does not include grant transfers, but provides machinery for the selected business ideas.

- Programme 2014 Budget: \$200,000
- Sample of projects: Plastic Recycling (Comoro), Flower cultivation (Bazartete), Ceramic (Maliana), Fishery (Oecusse)
- Monitoring & Evaluation: SEFOPE and IADE staff visit business initiatives regularly
- Key challenge: Students have no/limited management skills. They are required to attend 2-week training with IADE about management (how to create a business, bookkeeping and financial management, etc.)

Criteria:

- Groups of 10 to 15 people
- Proposal endorsed by local leaders
- Areas: home industry, agriculture, mechanic
- Groups are also expected to self-fund part of the required investments and expenses

Process:

- Submit proposal during the period of application (Jan to Jun): 400 proposals received in 2014
- Administrative council evaluates the proposals (July)
- Results and implementation in Aug
- 24 groups were supported in 2014; 35 groups in 2013

SECRETARY OF STATE FOR THE SUPPORT AND SOCIO-ECONOMICAL PROMOTION OF WOMEN (SEM)

SEM objective is the **Promotion of Gender Equality**, with focus in the following areas:

1. Promote women participation in politics
2. Promote women participation in the economy
3. Reduce violence against women
4. Support research and studies of gender

- Programme: Financial support for women groups (5 to 8 members) that want to start or just established a small business
 - months after receiving the grant)
 - Monitoring is conducted after 6 months
 - Successful groups may apply for a 2nd year grant (new proposal)
- Process:
 - Submit proposal, with local authorities support, during period of application (announced on RTTL and community radio). Normally in April/June depending on the budget approval period)
 - Almost 1,000 proposals received per year
 - Around 400 groups are selected to receive the transfers from 2008 until 2014, receiving values from \$1,000 to \$5,000 per group
 - Transfers directly deposited in the group's bank account (2008 to 2012 through ANZ, and since 2013 through BNCTL)
 - Prepare report regarding the usage of money received (2 to 3
- Approval: District focal points and gender working group (led by the district general secretary)
- Annual Budget for this programme:
 - 2008-2009: \$50,000
 - 2010: \$150,000
 - 2011-2012: \$100,000
 - 2013: \$200,000
 - 2014: \$120,000
- Support through NGOs where SEPI is not present. NGOs conduct training and manage small grants to local organizations, such as Forum Peduli Wanita in Oecusse, FKSH, APSCTL and CDC Baucau (grants of \$2,000 to \$5,000 per group and the criteria is established by each NGO)

In 2014 SEM budget included: \$100,000 to UNTL, \$100,000 to the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW), and \$100,000 for women in politics congress activities.

GOVERNMENT GRANTS SUMMARY

Ministries and government agencies support projects that are aligned with their respective priorities (type of commercial activity and region)

	Ministry of Commerce Industry and Environment	Ministry of Agriculture, Fisheries and Forests	Ministry of Tourism	Secretary of S. for Professional Training and Employment	S.S. for the Support and Socio-Economical Promotion of Women
Budget per year	\$3,200,000 to \$4,800,000	\$500,000	\$200,000	\$200,000	\$120,000 to \$150,000
Target Group	Cooperatives and business	Groups of around 10 members active in agriculture and willing to improve production	Already operating businesses, in the priority districts	Groups (around 10 to 15 members) willing to set up small industries	Women groups (5 to 8 members) to involved in economic activities / home industries
Objective	Foment commerce and industry, support cooperatives	Improve quality and productivity of crops, create jobs, promote advanced technology and technical skills	Improve and expand community based tourism businesses	Promote self-employment among participants of SEFOPE training programmes	Promote women participation in the economy
Support	Direct grants transfers, capacity development and technical support	\$3,000 to \$5,000 per group	\$5,000 per approved proposal	Machineries for the main activity	Around \$2,000 per group (same group may apply for a 2 nd year grant)

Secretary of State for Youth and Sports informed it has no grants programmes to support private sector currently. There is a plan to promote youth creativity (that may include grants, but it is not defined yet); they focus on creating Youth Centres in all districts (offering training), working in partnership with UNICEF, GIZ, and Peace Fund

PRIVATE SECTOR DEVELOPMENT PROJECTS



The two main DFAT projects related to private sector development are Seeds of Life (SoL) and Market Development Facility (MDF). The SoL project focuses on improvement of seeds for agricultural productions. MDF project focuses on implementing selected private initiatives, providing capital, and technical support (market chain development, capacity building, etc.) acting as a business incubator.

	Seeds of Life (SoL)	Market Development Facility (MDF)
Programme	<p>Testing improved varieties of food crop seeds (not genetically modified), and improving access to these seeds to all farmers throughout Timor-Leste. Since 2000, now in its 3rd and last phase (until mid-2016)</p> <p>Seed multiplication for maize, rice and peanut is done through farmer groups (more than 1,000 in 13 municipalities), and through local cuttings distribution centers for cassava and sweet potato. Successful farmer groups have associated in Commercial Seed Producers (57 in Jan 2015), and are registered by MAFF as producers for the local market (as part of the establishment of a National Seed System)</p>	<p>Partnership with local implementing partners, offering support to design business model, develop the value chain, build capacity, business advisors, and financial support (matched by the local partner). Financial support is made by reimbursement of defined expenses (software, trainings, etc.)</p> <p>Budget for 2014: \$ 1.2 Million</p> <p>6 to 18 months of intervention and monitoring for further 2 years</p>
Impact	<p>Goal: 50% of crop producing households in Timor-Leste use improved varieties of seeds (~65,000).</p> <p>Status in Sep 2014: 33% (~41,000) in all districts</p>	<p>Goal: 7 new projects/year (agribusiness, tourism, construction, manufacturing)</p>
Criteria	<p>For community seed production groups: Existing farmer groups that are interested to grow seed for their members and local communities. Some criteria on plot size and location to safeguard the quality of the seed.</p> <p>For Commercial Seed Producers: Registration by MAFF, based on meeting a set of criteria to guarantee the production of good quality seed, coupled to quality control during crop growth and post-harvest</p>	<p>Project evaluation: Sectors selected, potential for growth, pro-poor programmes and sustainability.</p> <p>Partner evaluation: financial situation, management capacity, and commitment to the project.</p>
Comments	<p>Key challenge is to build a strong basis for seed system management at municipal level</p>	<p>Key challenge is to identify the right partner and business advisors</p>

PRIVATE SECTOR DEVELOPMENT PROJECTS



NZAID conducts many projects to promote private sector in Timor-Leste. As detailed below, these projects are focused on: improving agricultural production (Agri-business), enhancing local business skills, and improving private sector environment. The “head of the mission fund” is an ambassador discretion fund to support projects that are not required to be related to private sector development.

	Agri-Business (Coffee)	Agri-Business	BOSS / ILO – IADE	Moris Rasik	Head of the Mission Fund
Programme	Coffee farm rehabilitation (transition process)	Agriculture Production in Maliana	Business Development Centre	Financial Literacy	
Impact	More than 5,000 farmers were trained		Around 4,500 businesses in its database	10,000 current clients & database expansion	Support 2 to 4 initiatives per year
Criteria	Cooperativa Café Timor (CCT) and National Cooperative Business Association (NCBA) coordinate the project	Coordinated by World Vision in Maliana	Open to all businesses and individuals for training and information	Focus on expanding the financial products available to its 10,000 rural clients, offering training financial literacy and basic management skills	Focus on development projects. Priority for rural areas. Support only groups at ambassador's discretion
Comments	Project funded by NZAID and USAID has finished. NZAID is discussing with NCBA and CCT to directly fund the coffee rehabilitation project. No direct grants given to farmers, it offers equipment, training, materials, and market linkages	Provides funding to World Vision for economic development activities, particularly to support farmer to increase agriculture production and link them to the market	IADE Business Plan Competition ; Business Incubator, and management trainings	Develop materials for basic financial literacy and management skills	Average support of \$20,000. Yearly budget of \$65,000

PRIVATE SECTOR DEVELOPMENT PROJECTS



USAID was going through a transition period during the collection of data. Their current **Developing Agricultural Communities (DAC)** project is in phase-out process. USAID is currently in the process of designing and approving a new project to expand its intervention to more districts. Current programme's key components are:

The project aims to stimulate the demand of locally produced agriculture products by:

- Improving the connection between agricultural producers and wholesaler partners (e.g.: wholesalers participate providing seeds and guarantee to buy the production)
- Offering technical support to improve quality and productivity of agricultural products
- Partnering with Timor Coffee Cooperative (CCT) for coffee farms rehabilitation (to renovate coffee trees, to grow cassava in the same area as coffee, to diversify production, to cultivate cocoa and vanilla beans, etc.)

Selection:

- Women farmers included in their programmes
- The selection is made at suku level, not farmers, based on the suku poverty indicators and agriculture activity
- Communities (within sukus) are selected based on a number of factors, such as suitability of the land and access to transportation to markets

GRANTS PROGRAMMES FOR PRIVATE SECTOR DEVELOPMENT

Government and International Development Agencies conduct programmes to promote the private sector, mainly focused on capacity development, and income generation

Government Ministries and Secretaries

- Ministry of Commerce, Industry and Environment (MCIA)
- Ministry of Agriculture, Forestry & Fisheries (MAFF)
- Ministry of Tourism (MoT)
- Secretary of State for Employment and Professional Training (SEFOPE)
- Secretary of State for the Support and Socio-Economical Promotion of Women (SEM)



- Ministries and government agencies support projects that are aligned with their respective priorities (type of activity and region)
- Plan to replace current subsidies by incentive programmes

Agencies for International Development

- DFAT: Seeds of Life (SoL) and Market Development Facility (MDF)
- NZAID: IADE - BOSS Programme, Coffee Farmers Rehabilitation Programme (in transition), and Head of the Mission Fund
- USAID: Coffee Farmers Rehabilitation Programme (phase-out process)



- Projects offer mainly technical support, equipment, materials, and only a few provide grants

Note: The report includes only main criteria for grant application. Criteria for grant application are constantly updated. Please consult the agencies directly for updated process, forms and criteria.

1.3. SUMMARY

SUPPLY ANALYSIS: SUMMARY

Bank loans, micro-finance and government grants are the most common options for business financing in Timor-Leste; however the requirements / criteria are not conducive to new small and medium entrepreneurs

Financial Services Providers

Commercial Banks

- ANZ
- BNU
- BNCTL
- Mandiri

Microfinance Institutions

- Moris Rasik
- Tuba Rai Metin



Commercial Banks

- Selective for loans accounts
- Just for clients with bank history
- Require collaterals, prove of financial ability to pay back, and official financial reports

Microfinance Institutions

- Small amounts and not for start ups
- High interest rates and additional costs (administrative fees and insurance)

Programmes for Private Sector Development

Government

- Ministries
- SEFOPE
- SEM
- SEAPRI

Development Partners Programmes



- Variety of micro grants/public transfer for business start up
- USD 10M injected in BNCTL to increase loans
- Loan Facility with BNCTL was planned to be developed by SEAPRI

Note: Savings Groups were not consulted, due to the relatively small amounts of the loans they offer.

KEY FINDINGS

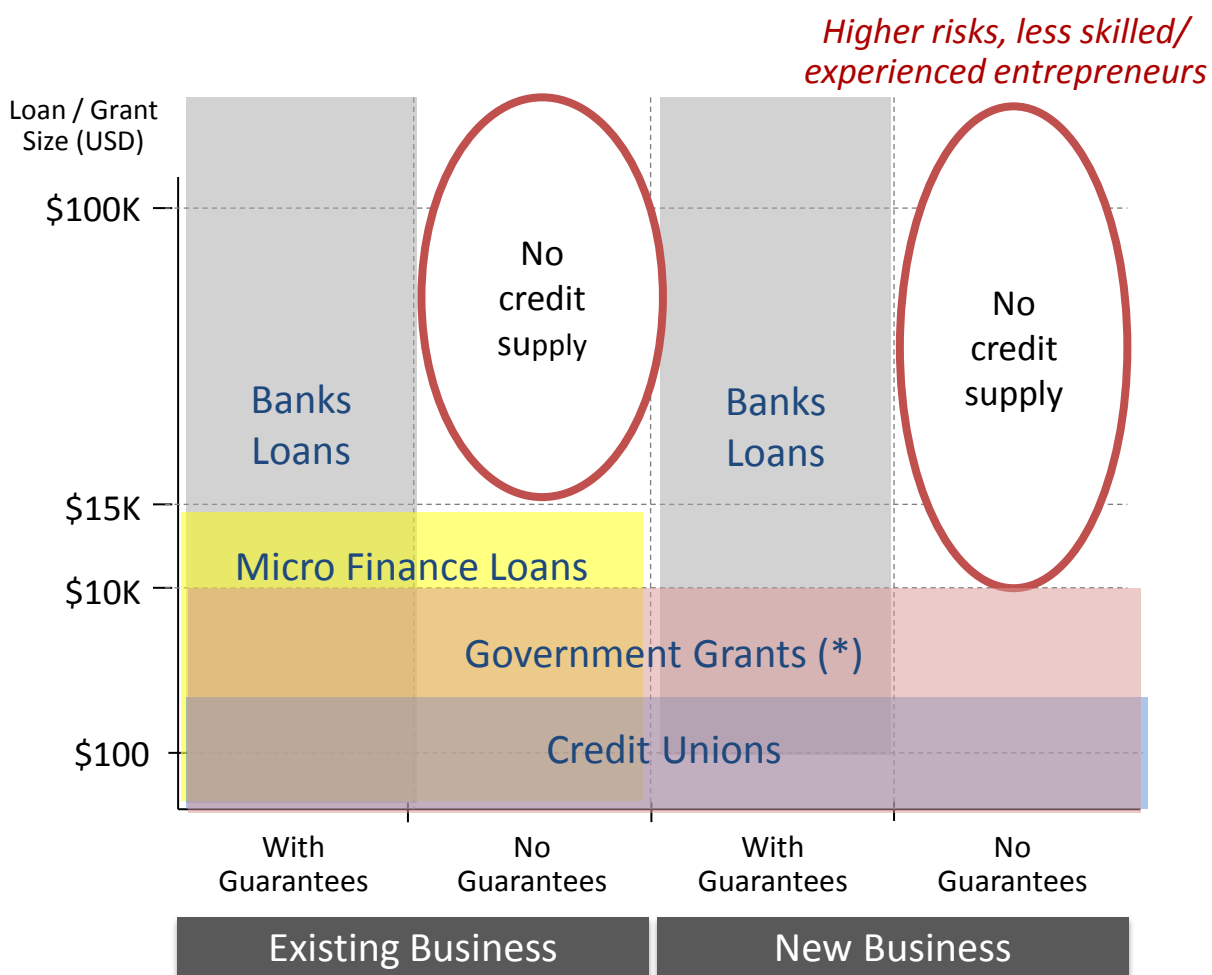
- Banks offer financing options for businesses, but they are **very selective**, requiring collaterals and credit history - which new entrepreneurs cannot provide
- Major banks had **records of high credit losses**, justifying their sceptical approach to Timorese credit market
- All banks **target loans backed by government contracts**, which represent a lower credit risk
- Microfinance institutions focus their activities on **micro entrepreneurs**, and businesses already established. **No loans start ups**, as they represent a high credit risk
- Microfinance interest rates advertised are **misleading**, as they (both) publish what they call “flat” interest rate, but the effective rate on their loans is around double the informed interest rate (**30% per year**)
- A major concern shared in the interviews is that Timor-Leste entrepreneurs represent high credit risk, due to lack of financial literacy, weak business skills, issues with land registries (that could serve as collaterals), etc. – implying a high credit cost
- Government agencies do offer support for micro business initiatives or large ones (attended by Trade Invest), but **no support for small and medium enterprises**
- Development partners programmes are mostly focused on capacity development and technical assistance – no direct grants with rare exceptions
- Timor-Leste **financial sector is small and relatively new**; it offers few alternatives for enterprise funding (e.g.: venture capital, impact investors)
- The country **doesn't have a credit bureau**; only a credit registry, managed by the Central Bank

RECOMMENDATIONS FOR THE SOCIAL BUSINESS FUND IMPLEMENTATION

- **Focus on entrepreneurs of small and medium sizes businesses** that are not served by the current financial market: loans of \$20,000 to \$100,000 (the segments coverage is represented graphically in the following page) - as micro loans are available, and large projects and companies are attended by the current financial sector.
- Extend the loans offer to served **start ups and also to expanding businesses** with restrict collateral
- Research the entrepreneurs profile (credit history, assets, education background, professional experience and expertise), in order to design **strategies to reduce credit risk**
- Accept more **creative and flexible loan collaterals**, such as shares of the enterprise, jointly manage, loan matching, etc.
- **Monitor business implementation** (usage of loans) to minimize/manage credit and operational risk
- Negotiate a **lower interest rate and better loan conditions** to offer to SMEs with high social impact potential, as the range of loan prices is large (from 5% to over 30% per year!)
- Make sure **clients understand** the loan product detail and its calculations
- Promote **alternative sources of funding**, such as angel investors and impact investors, mobilizing potential “sponsors” through events
- Advocacy for **interest rate regulation** – all market players should use international standards to calculate effective interest rates to inform clients. Or even one final rate including all costs incurred by the client (credit evaluation, insurance and administration fee) that would allow clients to easily compare loans available in the market and make smart decisions

ENTERPRISE FINANCING: SEGMENTS NOT SERVED

Entrepreneurs of small and medium sizes with no guarantees are not served by the current financial market



(*) Government grants based on the ministries' and secretaries' programmes (sector, activity, location)

1.4. COMPARATIVE ANALYSIS

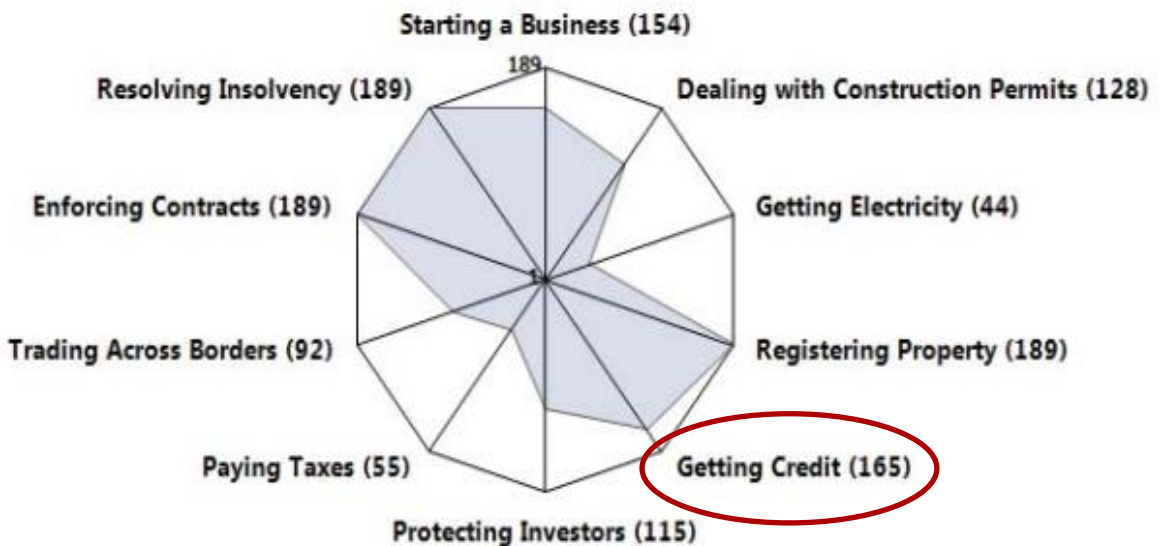
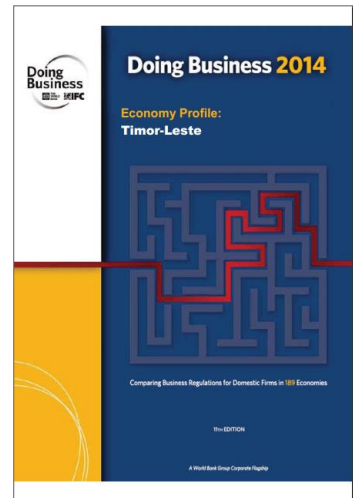
Major challenges for “doing business” in Timor-Leste and financing options available to Social Business in other countries

COMPARATIVE ANALYSIS

The World Bank “**Doing Business 2014**” Report ranked Timor-Leste 172th out of the 189 countries evaluated. The topics where Timor-Leste performed poorly are:

- **Resolving Insolvency: 189th**
- **Enforcing Contracts: 189th**
- **Registering Property: 189th**
- **Getting Credit: 165th out of 189**

The first 3 topics listed above impact negatively the ability of companies to obtain credit.



Source: The World Bank, “*Doing Business 2014 – Economy Profile: Timor-Leste – Comparing Business Regulation for Domestic Firms in 189 Economies*”

SB FINANCING OPTIONS IN DEVELOPED MARKETS

Social Businesses have more options for financing their activities in developed financial markets than in developing markets, such as Timor-Leste. The table below compares financing options available in Timor-Leste and in developed markets.

		Developed markets
• Self-Funding	✓	✓
• Banks	✓	✓
• MFIs	✓	✓
• Credit Unions	✓	✓
• Savings Groups	✓	✓
• Govt. micro-transfers & programmes	✓	✓
• Govt. Financing Programmes		✓
• International organizations & NGOs	✓	✓
• Crowdfunding		✓
• Angel Investors		✓
• Venture Capital		✓
• Private Equity		✓
• Social Impact Bonds		✓
• (Social) Stock Market		✓

SOURCES OF FINANCING & PHASES OF ENTERPRISE

The need of financing and its sources also varies based on the development phase of a new enterprise. The table below lists the four phases of a new enterprise and what type of funding sources are more adequate for each phase.

Phases	Needs & Sources of Financing
Conceptual (developing the idea)	Social enterprises can consider soliciting grants, gifts, and donations through <u>Foundations, Government programmes, philanthropists, and private individuals</u>
Developmental (starting to operate)	Raising capital to fund the ongoing operation of the business. <u>Investors with vested interests</u> will be more willing to invest as compared to venture capitalists or other financial institutions, who will certainly look at a combination of debt and equity financing
Growth (reasonable sales volume and close to break-even)	As there is still little or no previous records of earnings, it will still be difficult to get debt financing from traditional institutions. <u>Alternative funding methods may be factoring of inventory and accounts receivable</u> , as these do not require profitable operations. Banks will be keener to establish a deposit relationship then to lend at this stage of maturity
Mature (well established in the market)	The business does not need to borrow frequently, unless it is for specific activities such as development of new products, and acquisitions. There will be <u>no lack of financing options</u> (loans, mortgages, bonds) for businesses at the mature stage.

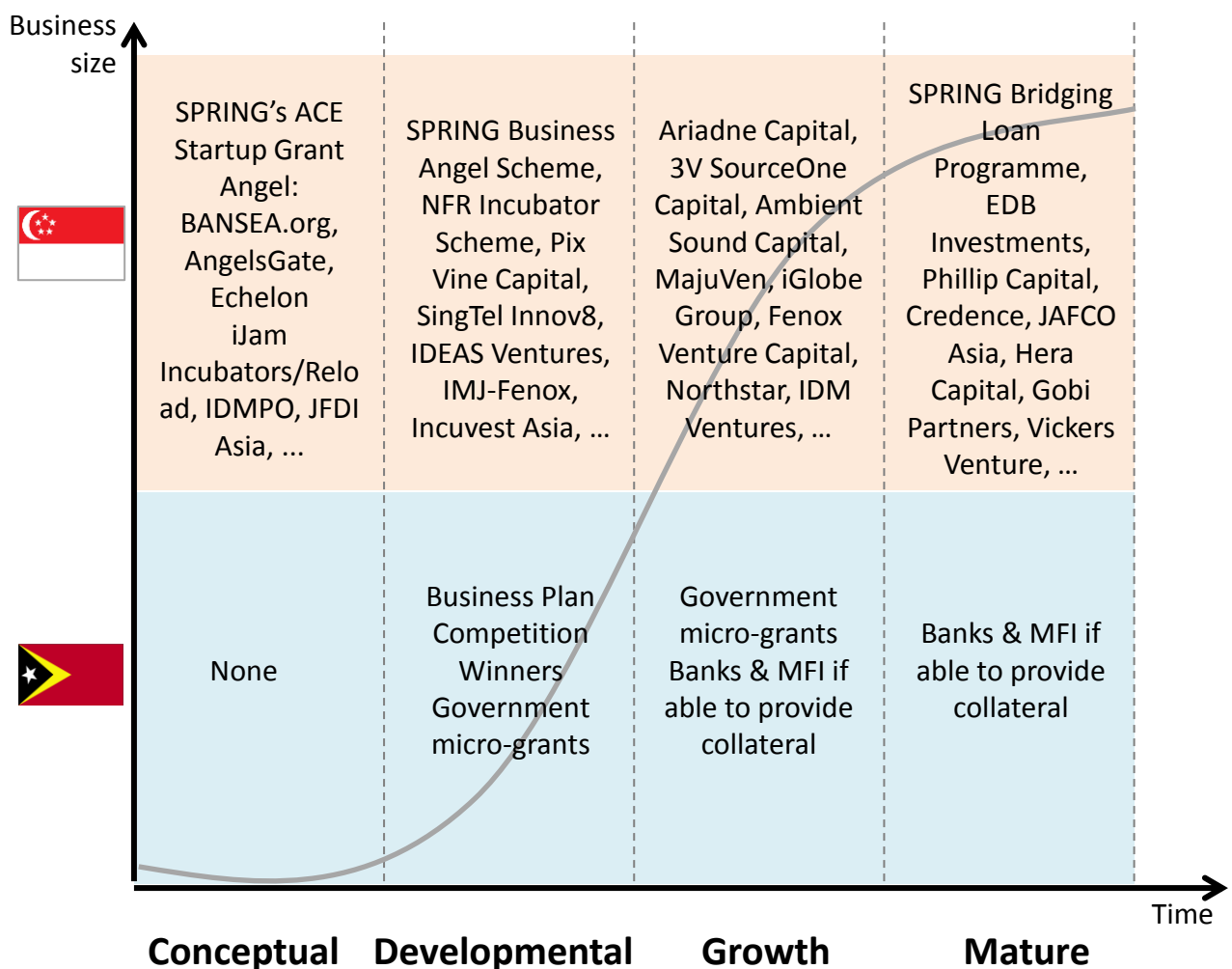
Source: [Social Enterprise Association Toolkit for Start-ups](#)

FINANCING ALONG THE BUSINESS LIFECYCLE: SINGAPORE CASE

The graphic below compares the financial options of financial markets in Singapore and in Timor-Leste.

Singapore was selected as an example of a developed financial market that offers many options to finance enterprises in every stage of its lifecycle.

On the other hand, Timor-Leste has a new and developing financial market. In Timor-Leste there are few options for finance enterprises, suggesting high financing costs.



Source: [Social Enterprise Association Toolkit for Start-ups](#) and [Startup Funding in Singapore Map](#)

2. DEMAND ANALYSIS

Assessment of the demand for SME funding mechanism

Section Content:

2.1. Surveys and Reports

2.2. District Consultation

2.3. Business Plan Competitions

2.4. Key Findings & Recommendations

DEMAND ANALYSIS

SMEs are considered an engine of economic growth, adding resilience during economic crises, and responsible for a large proportion of job creation. Timor-Leste would benefit from having more SMEs and a vibrant private sector.

However, are the Timorese willing to be entrepreneurs? What kind of business would the Timorese like to start? What are their main challenges? These are the questions addressed in the demand analysis.

This chapter analyses data from:

- **Private sector and labour force surveys** to understand the potential market for MSMEs
- The **district consultation** that we conducted to collect primary data on entrepreneurship;; meeting with entrepreneurs and potential entrepreneurs in all 13 municipalities helped clarify details about key challenges and financial services available to finance their businesses
- Results from **business plan competitions** to know what type of businesses are the Timorese interested in.

Research Resources	District Consultation	Business Plan Competitions
<ul style="list-style-type: none">• Serviço de Registo e Verificação Empresarial (SERVE)• Private Sector Survey• Labour Force Survey	<ul style="list-style-type: none">• Focus Group Discussions around the country	<ul style="list-style-type: none">• Instituto de Apoio ao Desenvolvimento Empresarial (IADE)• Câmara de Comércio e Indústria (CCI-TL)

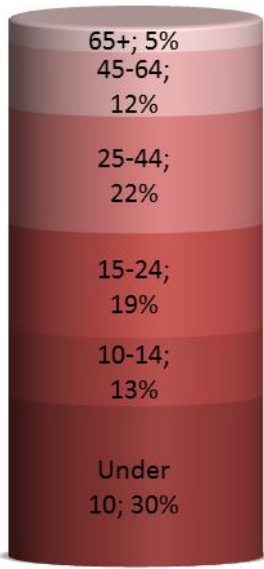
2.1. SURVEYS AND REPORTS



ECONOMICALLY ACTIVE POPULATION

Timor-Leste Population

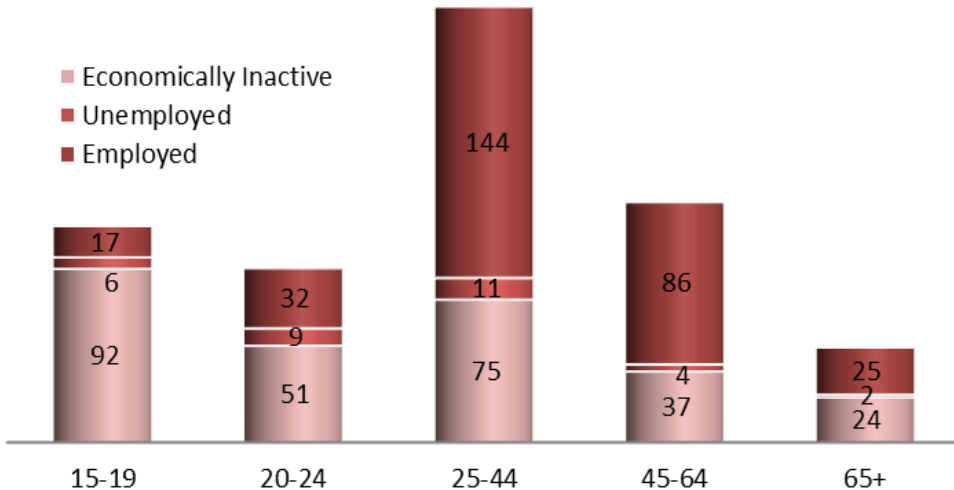
Total 1,066,409 - Census 2010



Population by Age Group

- **43% of the population is under 15 years old**
- **The economically active population (15-64) totalled 308,385 (29% of the population);** down from the 2004 survey when 320,747 were reported
- Despite the **unemployment rate of 9.8%**, the **participation rate** of the population aged 15 and above is just **49.3%**:
 - 30,353 Unemployed
 - 255,319 Economically inactive population
- There are 8,324 employed people aged from 10 to 14 years old

Population Aged 15 and Over by Main Economic Activity (in '000)

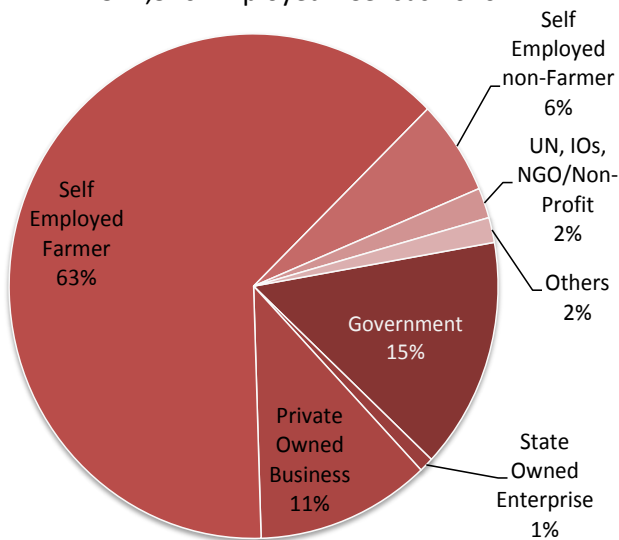


Source: Timor-Leste Census 2010, Volume 3, Tables: 11

EMPLOYMENT ACTIVITY

Timor-Leste Employment Sector

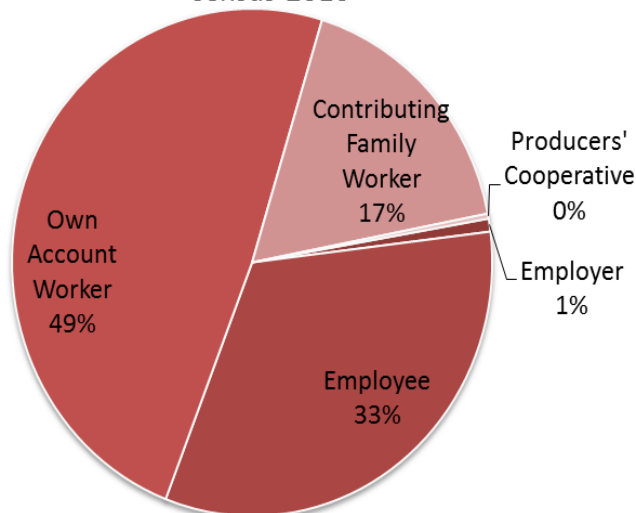
311,316 Employed - Census 2010



- Almost **70%** of the employed population is **self-employed**, mostly in the primary sector
 - 196,429 Farmers
 - 18,920 Non-Farmers
- 11% are employed in privately-owned businesses (35,844 persons)
- **Vulnerable employment rate** (own-account workers and contributing family workers – with no social security nor stable income) represents **66%** of employed persons
- Government and State-Owned Enterprises employ 16% of the employed population (49,104 persons) – OECD average is 22%

Timor-Leste Employment Status

Census 2010



Source: Timor-Leste Census 2010, Volume 3, Tables: 14

BUSINESS CONSOLIDATED DATA AVAILABLE IN TIMOR-LESTE

There are a few business databases available, but there is no precise number of operating businesses in Timor-Leste. The main business databases are:

- **Serviço de Registo e Verificação Empresarial (SERVE): 15,000 total registered businesses** (from 2008 until March 2014)

However, SERVE does not classify business by size neither maintains a status information (businesses can be inactive or even terminated, but still in SERVE records).

- **IADE database: almost 4,000 businesses**

IADE maintains a database of businesses that have voluntarily registered with them to enrol in trainings or to receive information of government procurement notices in their area of activity.

- **85%** of the businesses registered are **micro and small enterprises**; the remaining 15% are registered as medium enterprises
- The top 3 areas among all registered businesses are: **Construction (28%), Food Processing (19%), and Agriculture and Fishing (7.4%)**

- **Business Activity Survey of Timor-Leste 2012 (BAS 2012): 5,879 businesses**

BAS has not been updated lately, and it excludes petroleum-related businesses, agricultural production, and not-for profit organizations with less than 50% of revenues from trading activity.

- 4,525 (77%) businesses are located in Dili, and create 52,600 jobs (83% of total jobs)
- 1,354 (23%) businesses in other municipalities, create 10,600 jobs
- Just 3,395 businesses filed tax in 2012 and 330 businesses were not required or expected to file tax

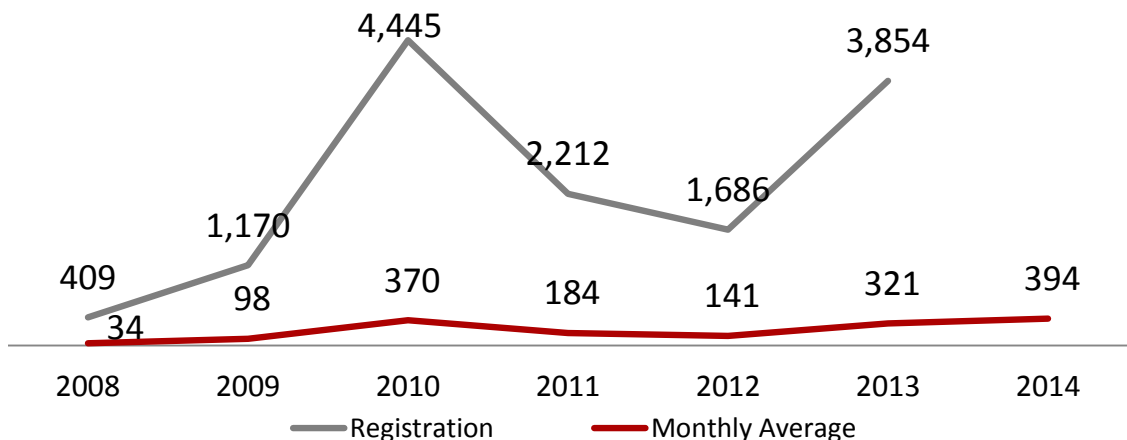
Due to different criteria of business databases available, it is difficult to know the exact number of businesses operating in Timor-Leste

BUSINESS REGISTRY AND VERIFICATION (SERVE)

SERVE was created with International Finance Corporation (IFC) support. It started to register businesses in June 2013. **Business registry is done in 5 days at no cost, but requires minimum capital of USD 5,000**

- **More than 300 new businesses are registered on average per month in 2013 and 2014**
- Businesses are highly concentrated in Dili:
 - 60% of the businesses registered are in Dili (SERVE data of 1st quarter of 2014)
 - 77% according to the Business Activity Survey of Timor-Leste 2012 (BAS-TL)
- SERVE plans to collect documents for business registry in municipalities through CDEs/IADE to facilitate registration in municipalities
- **Total number of registered businesses from 2008 to March 2014 is just below 15,000**
- **No update on the business status** – there is no practice of reporting business closures

Business Registry






Source: SERVE Reports on numbers of business registered, IADE website <http://www.iade.gov.tl/en/business-man/departamentu-registro-publico/moj/>

COUNTRY COMPARISON: MSME INDICATORS

“MSME Density” is an indicator used to compare countries based on the number of MSMEs by the population. According to this indicator:

Timor-Leste has low “MSME Density” – it varies from 4.5 to 17.4 depending on the source, while Indonesia’s is 100 to 226

MSME Indicators	Globally: 132 countries (*1)	Asia: 14 countries (*2)	 Indonesia	 Cambodia (*2)	 Timor-Leste
# MSME	125 Million (formally registered)	111 Million	22.7 million (*1 formally registered) 56.5 million (*2)	504,353	4,138 (*1) to 18,504 (*3)
% MSME / Enterprises		98%	99.9% (*2)	99.8%	100% (*4)
MSME jobs	27% to 45%	66%	97% (*2)	73%	99.5% (*5)
MSME Density (# MSME/1,000 people)	31	59.1 (*6)	100 (*1) to 226 (*2)	32.7	4.5 (*1) to 17.4 (*3)
MSME Contribution to GDP		38%	59% (*2)		

MSME report from the World Bank/IFC (*1), classifies business size as follows:

- Micro: 1 to 9 employees;
- Small: 10 to 49 employees;
- Medium: 50 to 249 employees

If the country has a different definition, World Bank follows the local definition. For Timor-Leste, Medium Enterprises have between 51 and 100 employees.

Asia MSME Finance Monitor report from ADB (*2), classifies business size based on the local definition

- Indonesia: based on total assets and annual net sales
- Cambodia: employees (up to 100) and net assets

Sources: (*1) Kushnir, Krystyna and others - Micro, Small and Medium Enterprises Around the World: How Many Are There, and What Affects the Count?; World Bank / IFC, 2010; (*2) Asia SME Finance Monitor, Asia Development Bank, 2013; (*3) Considering all registered businesses since 2008 and annualizing 2014; (*4) Based on IADE data; (*5) Timor-Leste Labour Force Survey 2010, (*6) No data available for Bangladesh, China, Sri Lanka

2.2. DISTRICT CONSULTATION



DISCLAIMER: Information presented in the next slides reflects the data collected in the focus group discussions and in written survey forms, between July and October 2014 in all municipalities. 182 participants were classified as “future entrepreneurs” and 384 as “business owners”. This isn’t representative of the complete Timor-Leste business activity, since the selection of participants was not randomized. The focus of this qualitative survey was to understand key challenges and the use of financial services.

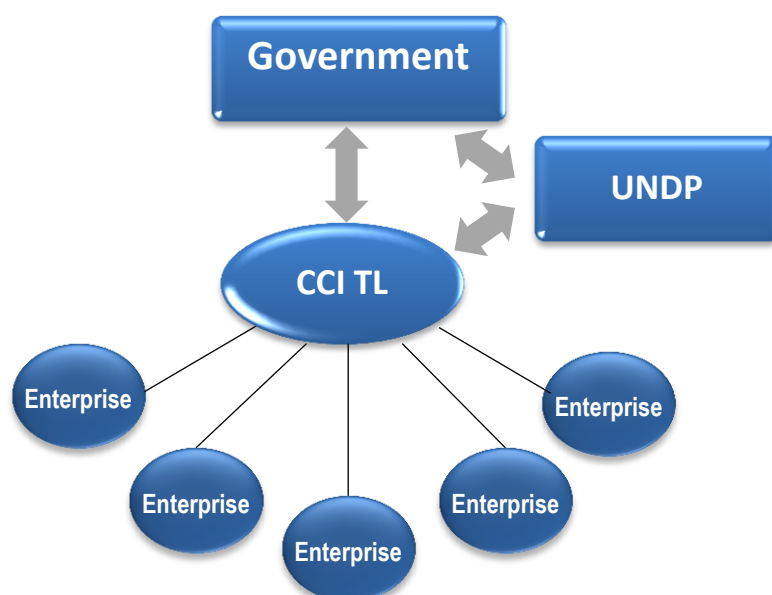
DISTRICT CONSULTATION & COORDINATOR PARTNER

To better understand entrepreneurs' interests and challenges we conducted district consultations in all 13 municipalities. Consultations were based on surveys and a focus group meeting to discuss pre-defined questions about businesses, challenges and finance practices.

The Chamber of Commerce and Industry Timor-Leste (CCI-TL) was selected as coordinator partner to organize the meetings.

Chamber of Commerce and Industry Timor-Leste was chosen taking into account that:

- It is in the position to foment discussion among entrepreneurs about challenges and potential solutions to promote entrepreneurship
- It has a key role providing a united voice and leadership on business issues
- It was a natural partner to be responsible for identifying and making the connection with current and potential entrepreneurs across Timor-Leste



DISTRICT CONSULTATION METHODOLOGY

Initially we decided to organize **Focus Group Discussions (FGD)** conducted by a local facilitator based on pre-defined discussion questions, and using a survey form for demographic information. After a pilot FGD, we decided to include key questions in the written survey, as some participants were not able to attend the meetings, and to reduce the influence of others' responses to the questions.

Facilitators received training on the profile of participants and how to conduct a focus group discussion.

- We had 2 participant profiles: **business owners** (382 participants) and **future entrepreneurs** (182 participants)
- A CCI representative in each municipality supported the selection of participants based on their database of members and key business activities in the municipality
- Topics to be discussed: main challenges to start a business, management training, plans to start (or expand) a business, financing options
- 2-hour discussion with 8 to 12 participants
- Survey forms to be completed before the focus group discussion
- Specific focus group for women entrepreneurs in Dili



FOCUS GROUP DISCUSSION: MAP OF ACTIVITIES

Legend:

Municipality

Location of FGD
 E = # Entrepreneurs FGD
 (# participants)
 FE = # Future Entrepreneurs
 FGD (# participants)

Dili

CCI-TL Office
 E: 4 (28 women; 23 men)
 FE: 2 (10 women; 17 men)

Aileu

Note: Only Surveys, no FGD in Aileu
 E: 1 (8 women; 7 men)
 FE: 1 (6 women; 8 men)

Manatuto

District Administration Building
 E: 2 (10 women; 18 men)
 FE: 1 (5 women; 14 men)

Baucau

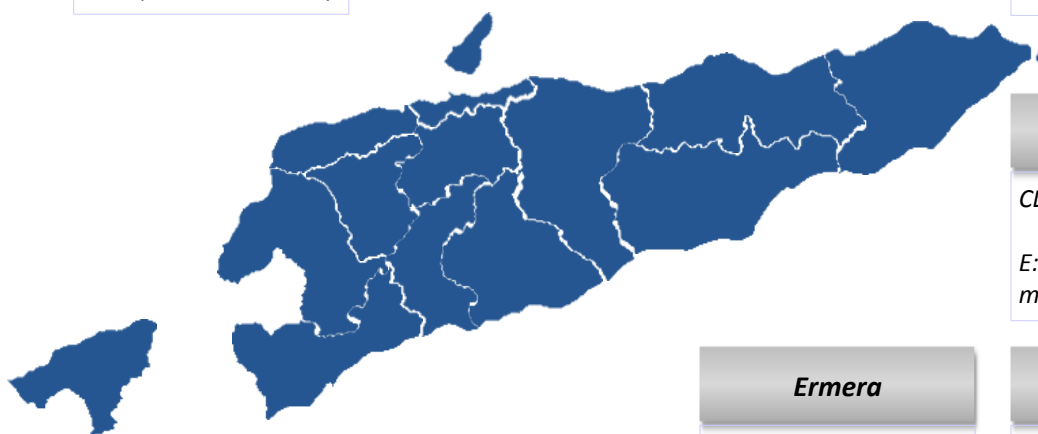
CDE Office
 E: 3 (15 women; 28 men)
 FE: 1 (6 women; 9 men)

Liquiça

CCI – Liquiça Office
 E: 1 (6 women; 10 men)
 FE: 1 (5 women; 7 men)

Lautem

Esperança Guesthouse
 E: 3 (11 women; 22 men)
 FE: 1 (2 women; 7 men)



Viqueque

CDE Office
 E: 2 (11 women; 14 men)

Ermera

CDE Office
 E: 1 (4 women; 6 men)
 FE: 1 (1 women; 6 men)

Manufahi

CCI Manufahi Area
 E: 1 (4 women; 12 men)
 FE: 1 (4 women; 13 men)

Oecusse

CDE Office
 E: 3 (21 women; 27 men)
 FE: 1 (6 women; 9 men)

Bobonaro

CDE Office
 E: 2 (11 women; 13 men)
 FE: 1 (7 women; 9 men)

Covalima

CDE Office
 E: 3 (18 women; 31 men)
 FE: 1 (7 women; 8 men)

Ainaro

CDE Office
 E: 2 (10 women; 14 men)
 FE: 1 (5 women; 11 men)

TARGET PARTICIPANTS

	Future Entrepreneurs (considering to start their own business)	Entrepreneurs (owners of small and medium enterprises)
Target Participants	People considering to starting a business	Business Owners
Business Size (*)		Capital between \$10,000 and \$200,000
Profile / Type of Activity	Includes: farmers, students (older than 18), unemployed, employed, etc...	Diverse type of activities, no more than 3 from the same activity per group
Size of Each Group	Invite between around 15 participants, aiming for 8 to 12 per Focus Group	Invite between around 15 participants, aiming for 8 to 12 per Focus Group

FUTURE ENTREPRENEURS: FOCUS GROUPS KEY INSIGHTS

Based on the written surveys and the focus group discussions, key insights from “future entrepreneurs” are:

- Most prefer to start their **business alone** (no business partners), even with limited capital to invest and business knowledge
- **Limited management skills:** they have a business idea, but are not able to elaborate a plan, calculate the investments needed, analyse the market conditions, etc.
- **Limited financial knowledge** to manage a the finances of the business and to understand loan terms and calculations
- When asked about “**fair**” **interest rates** most of them **do not know how to answer**; they mentioned lower rates, but were not sure about current rates used by MFIs and banks
- Youth participants demonstrate **limited experience working with banks or MFIs**, hence most do not consider financial services as possibilities for funding
- Many participants of business plan competitions have **developed different business ideas** for each competition, suggesting a superficial commitment (no passion) and knowledge

“I prefer not to use a bank or microfinance institution. If my business idea does not evolve as expected... they would send me to Hotel Becora [local prison]!”

“Interest rates are ok; period needs to be extended”

“BNCTL offers loans starting from \$2k for those who just started doing business. The amount is low; I do not remember the rate”

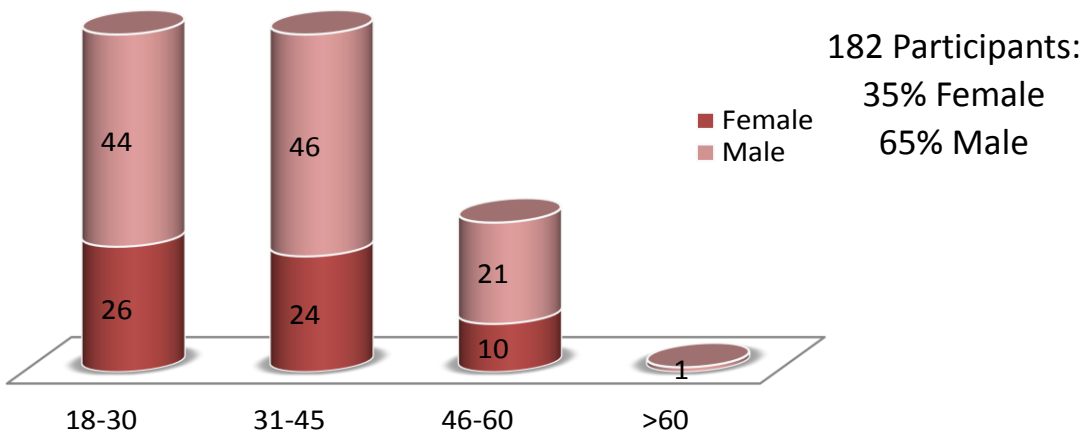
“I tried loans from BNCTL & BNU but both banks only prioritise civil servants”

“I never thought about a loan from a bank or MFI and never tried to apply, but if there's an opportunity I will try”

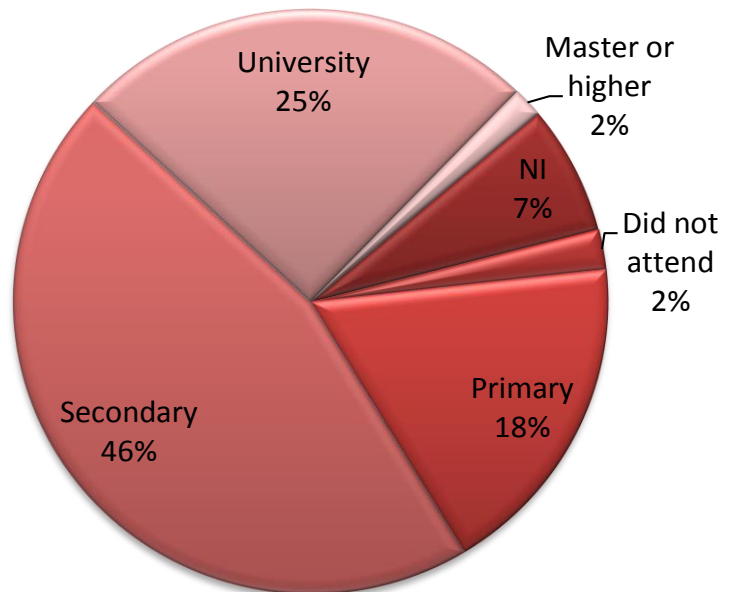
FUTURE ENTREPRENEURS: WHO ARE THEY?

Participants were predominantly male (65%), and from 18 to 45 years old (77%). Only 27% attended university

Gender & Age Group



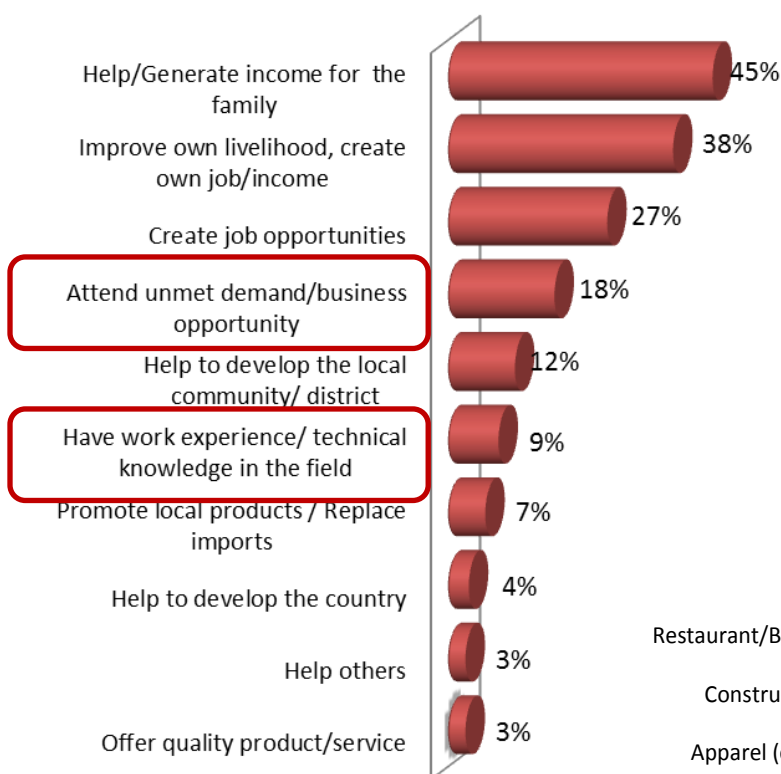
Formal Education Level



FUTURE ENTREPRENEURS: MOTIVATIONS & BUSINESS IDEAS

Main motivations to start a business are related to income generation. Business motivations (market opportunity) were mentioned by only 18% of the participants, while having the necessary skills or working experience in the field was mentioned just by 9%

Main Motivation to Start a Business



Business Ideas

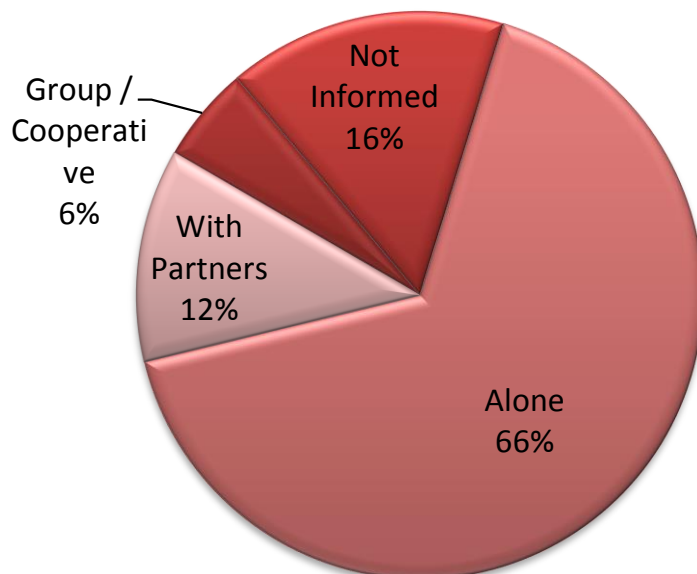


The most common business ideas are related to **agriculture** (46%) and **minimarkets** (27%)

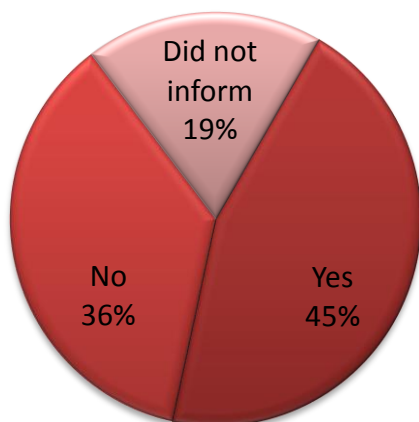
FUTURE ENTREPRENEURS: PARTNERS & SUPPORT

Despite the challenges to start a business, most participants prefer to start alone, with no partners. Organizations that offer training on how to start and manage businesses are quite popular: 45% of participants said they are working or had worked with them

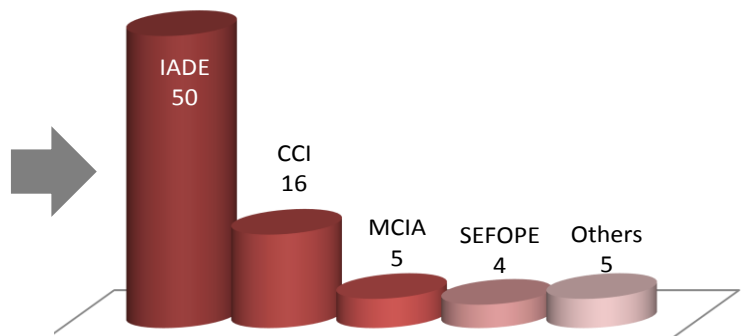
Starting a Business Alone or with Partners?



Are you working with any organization?



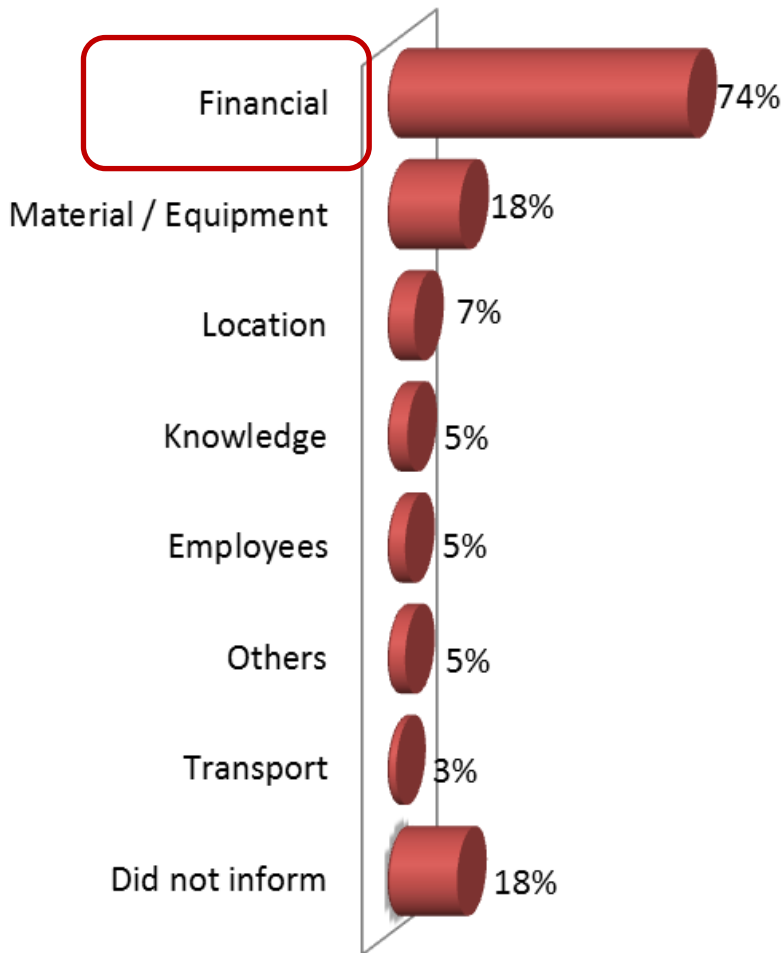
Supporting Organization



FUTURE ENTREPRENEURS: KEY CHALLENGES

Access to Finance was considered the main challenge to start a business. Most participants are concerned about using loans as a source of capital

Why haven't you started your business yet?



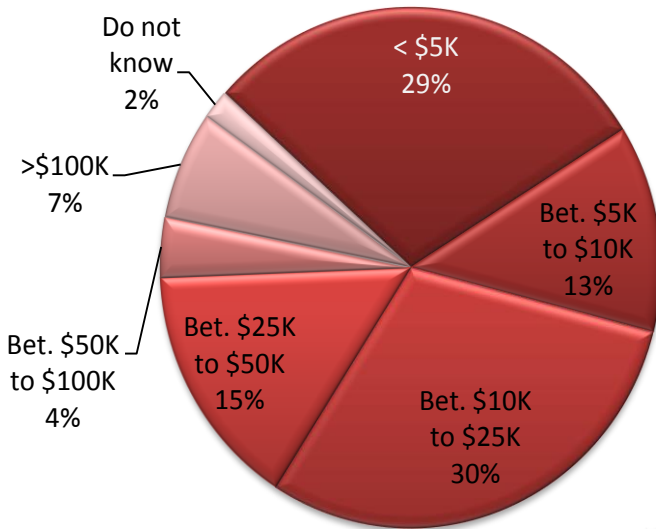
FUTURE ENTREPRENEURS: FINANCIAL NEEDS

Youth from business plan competitions have no/limited experience. Some have presented more than one business idea for competitions, suggesting **no clear idea** of the field/area they want to focus on.

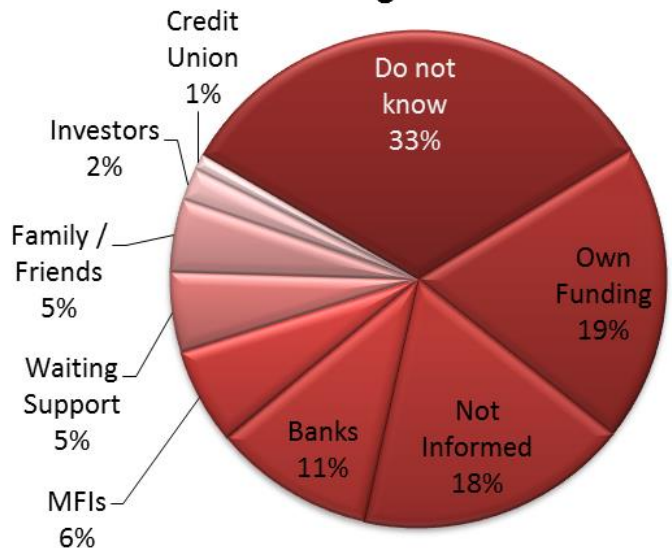
Older participants have not developed a business plan and seemed to estimate the capital required based on the amount they believe they can get.

In general, **investment estimates are superficial**

Business Ideas: Expected Investment



Source of Funding Considered

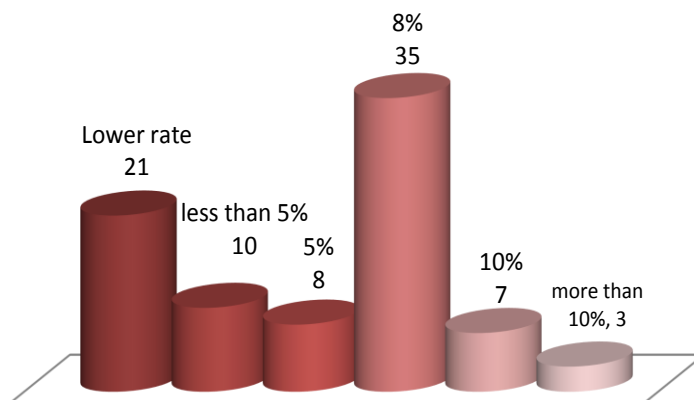


FUTURE ENTREPRENEURS: “FAIR” LOAN CONDITIONS

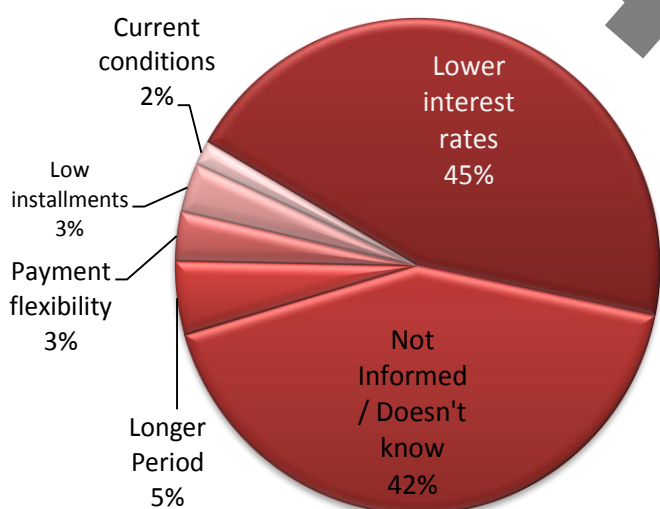
Many participants talked about the high interest rates, but most of them **do not understand how to calculate interest rates and instalments.**

Some suggested lower interest rates, but did not know how much they would consider to be “fair”

“Fair” Loan Interest Rate (p.a.)



“Fair” Loan Conditions



In the written survey, most participants did not answer the question, while in the focus group discussions most participants would agree/follow others’ opinion (i.e., the first ones to respond tended to anchor others’ responses). If there were no responses for the “fair” conditions, we suggested 8% p.a. and asked their opinion.

TARGET PARTICIPANTS

	Future Entrepreneurs (considering to start their own business)	Entrepreneurs (owners of small and medium enterprises)
Target Participants	People considering to starting a business	Business Owners
Business Size (*)		Capital between \$10,000 and \$200,000
Profile / Type of Activity	Includes: farmers, students (older than 18), unemployed, employed, etc...	Diverse type of activities, no more than 3 from the same activity per group
Size of Each Group	Invite between around 15 participants, aiming for 8 to 12 per Focus Group	Invite between around 15 participants, aiming for 8 to 12 per Focus Group

(*) JICA Report defines Small & Medium Enterprises as enterprises with 5 to 10 employees, annual sales of USD 60,000 to USD 100,000 (“Data Collection Survey on Industrial Development for Republic of Timor-Leste – Progress Report”, March 2014)

BUSINESS OWNERS: FOCUS GROUPS KEY INSIGHTS

Based on the written surveys and the focus group discussions, the key insights from “business owners” are:

- Most started their **business alone** (no business partners), even with limited capital to invest and business knowledge
- **Limited financial knowledge** to manage their business finance and to understand loan terms and calculations
- Frequently unclear separation between **individual finance and business finance**
- Main concerns about using banks or micro-finance institutions are: **strict criteria** for credit approval, not being able to pay back, low loan values, **high interest rates**, short loan period
- When asked about “fair” interest rates: most of them **do not know how to answer**; some say from 5% to 10% p.a. and a few mention 1% to 2% p.a.
- Many participants **complained about price control** of commodities; some mentioned that the government should set more controls, while others complained about too much price control
- Concerns about competition and unfair advantages of **foreign business owners** were mentioned in Viqueque and Oecussi

“Banks do not inform the interest rate of loans to us (clients)... it is a secret”

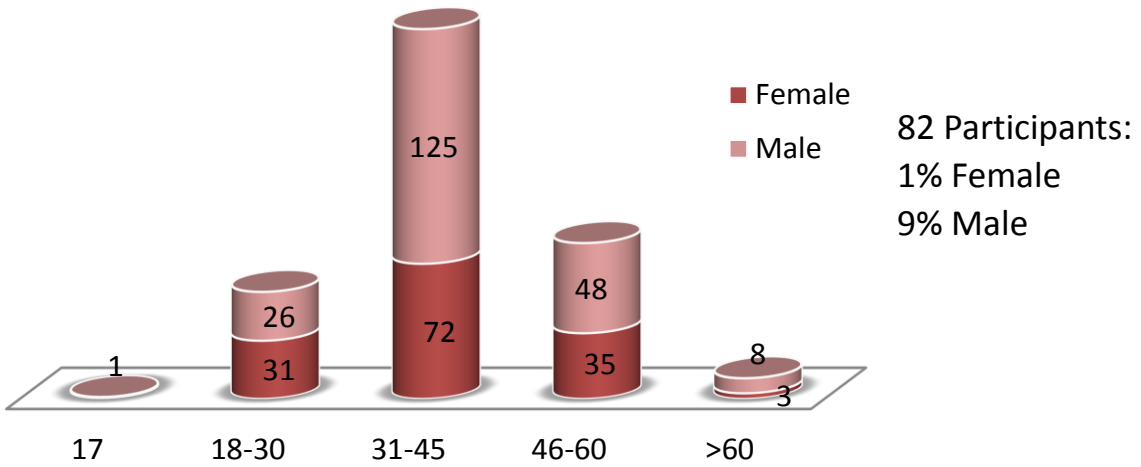
“I need to construct a warehouse as part of my business – how can I use a loan if I need to start to pay back the loan already after a month?”

“I want to invest in a new business. ‘A bank’ offered me a loan (I did not ask for it), but the amount was lower than what I already have in deposits... I preferred to save a bit more and invest later by myself”

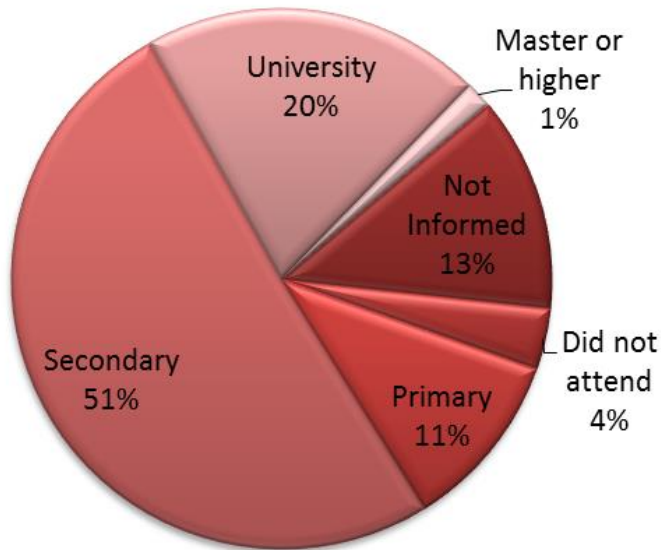
BUSINESS OWNERS: WHO ARE THEY?

Business owners of small and medium enterprises, from diverse sectors that represent the private sector of each municipality

Gender & Age Group



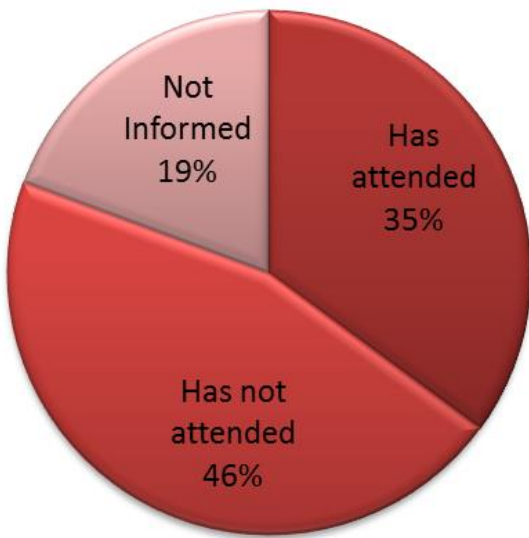
Formal Education Level



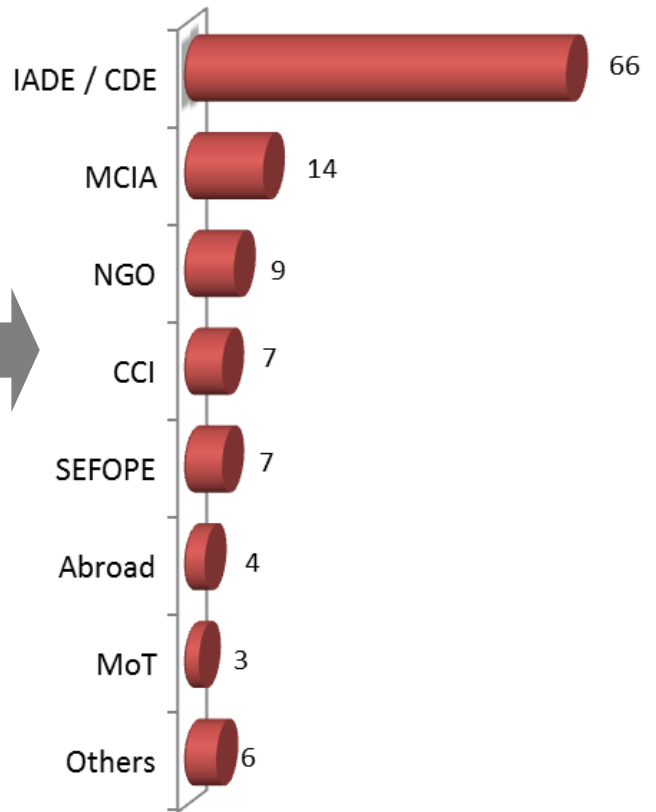
BUSINESS OWNERS: MANAGEMENT SKILLS

Among business owners, IADE / CDE is the major provider of management training

Management Skills Training



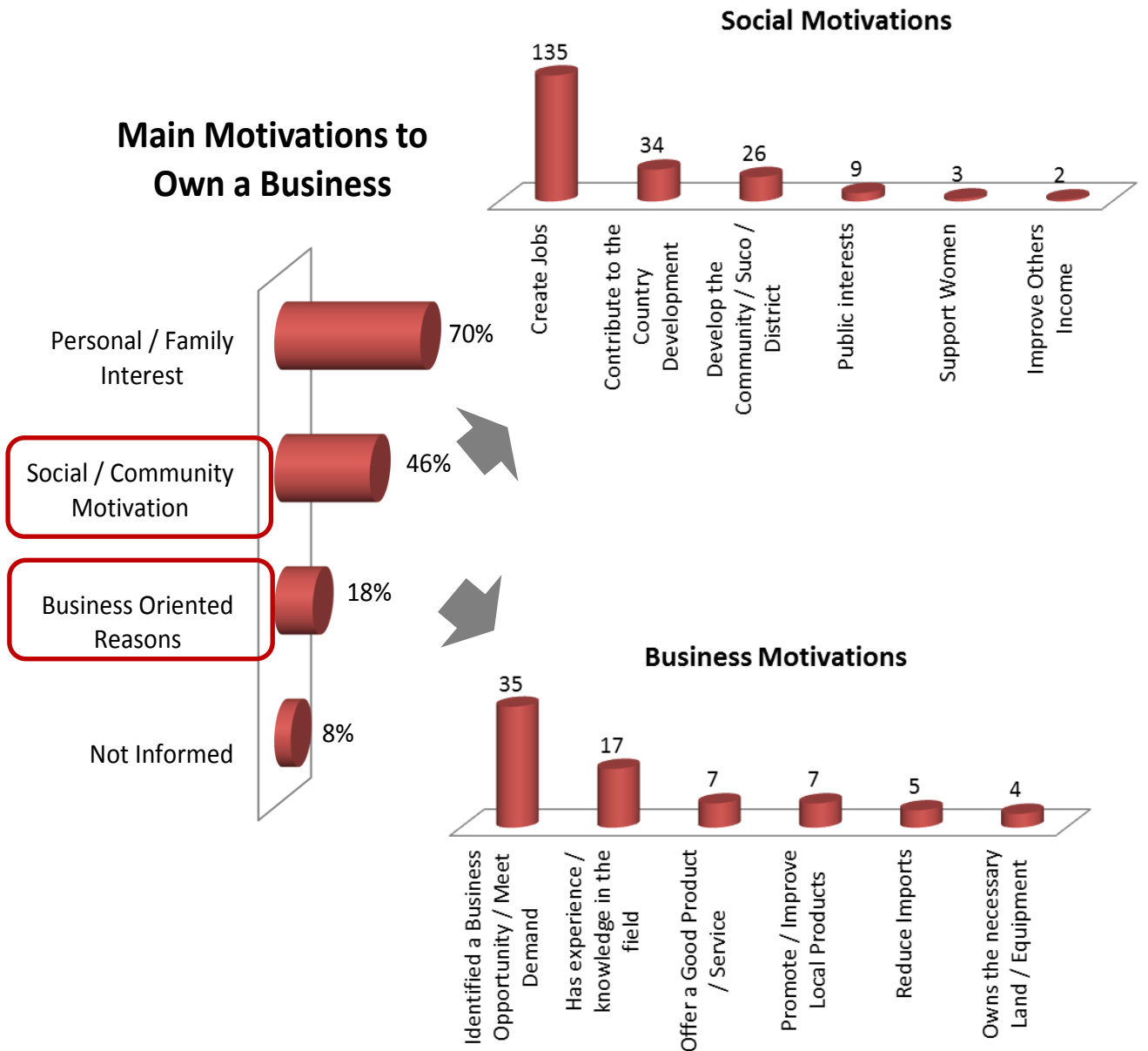
Management Training



Others: 2 participants graduated from other management courses, and 1 participant mentioned internet training.

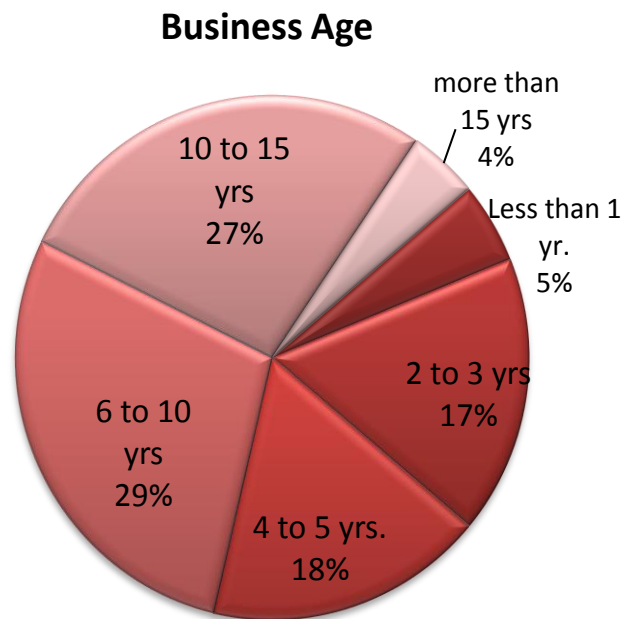
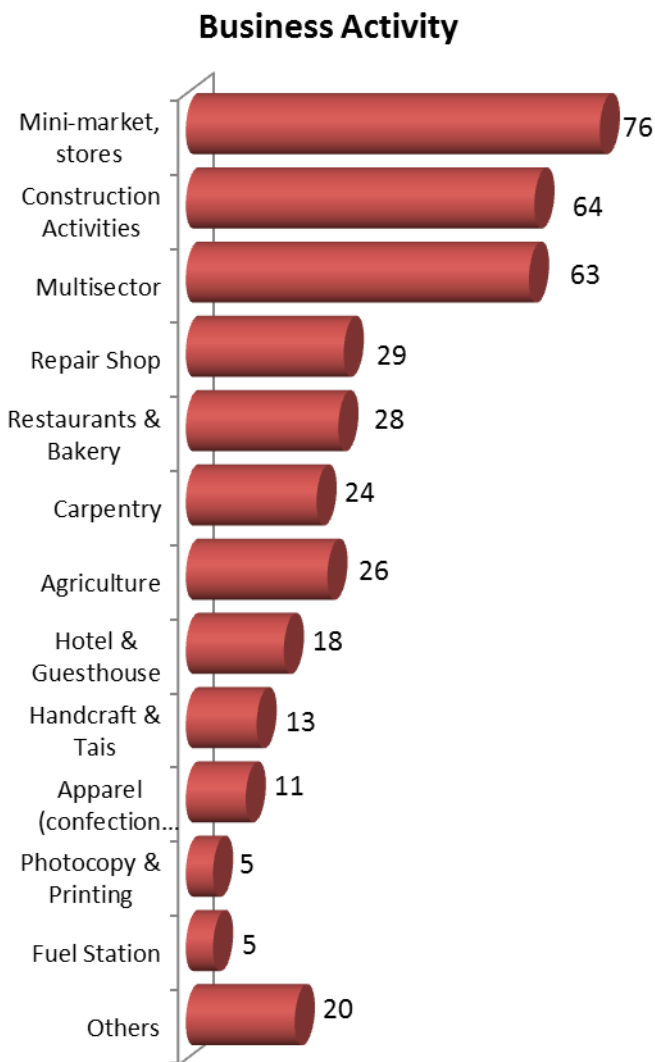
BUSINESS OWNERS: MOTIVATIONS

Main motivation to start a business is income generation. Social motivations were mentioned by 46%, while business motivations (market opportunities) were mentioned by only 18% of the participants



BUSINESS OWNERS: BUSINESS ACTIVITIES

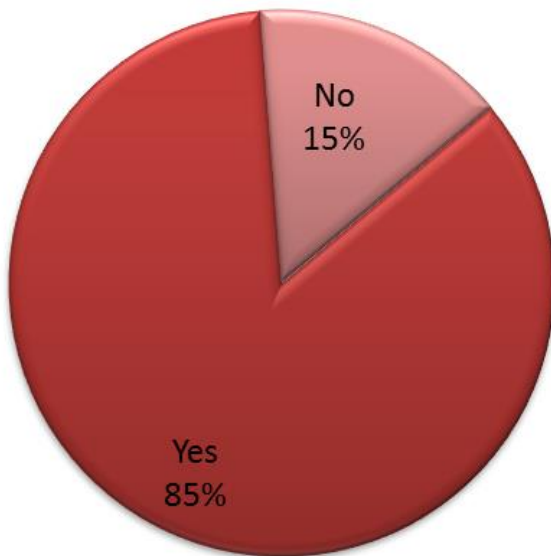
60% of participants have had their business for more than 5 years.
 The most represented business activities in the survey are: minimarkets (20%), construction (17%), and multisector (16%)



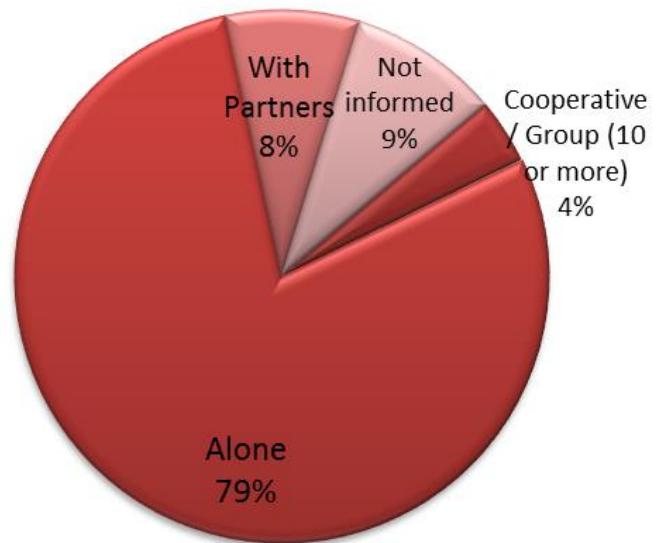
BUSINESS OWNERS: BUSINESS FORMALIZATION & PARTNERS

Most participants said their business is properly registered. Similar to Future Entrepreneurs' intentions, most Business owners preferred to start their business alone

Registered Business



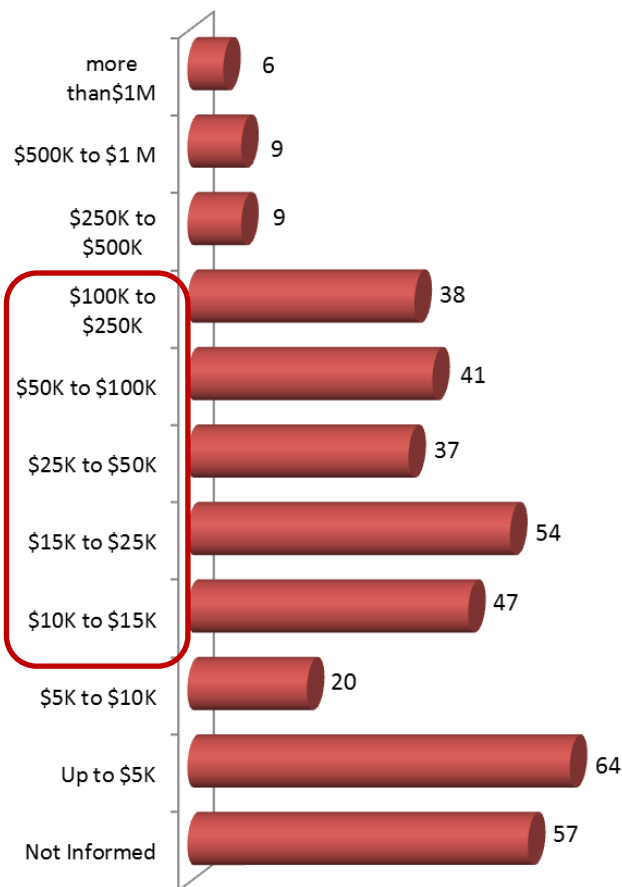
Partners or Solo



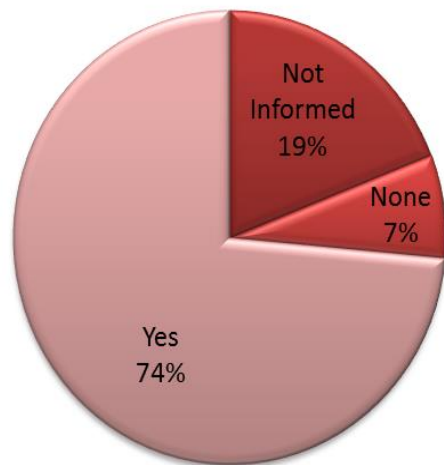
BUSINESS OWNERS: BUSINESS SIZE

59% of the business represented have up to 10 full-time employees, and 7% don't have full-time employees

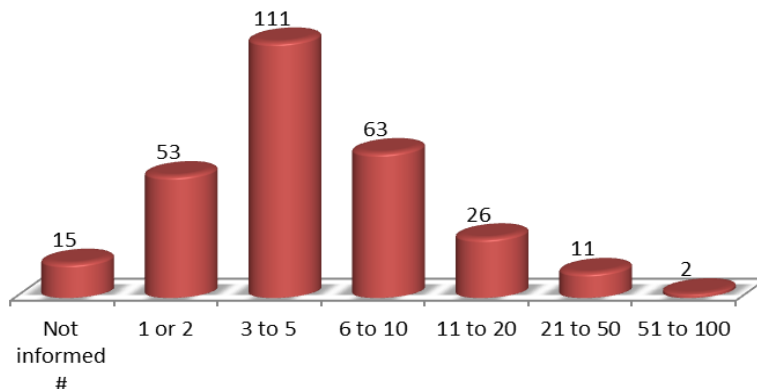
Business Size: Capital in USD



Full-Time Employees



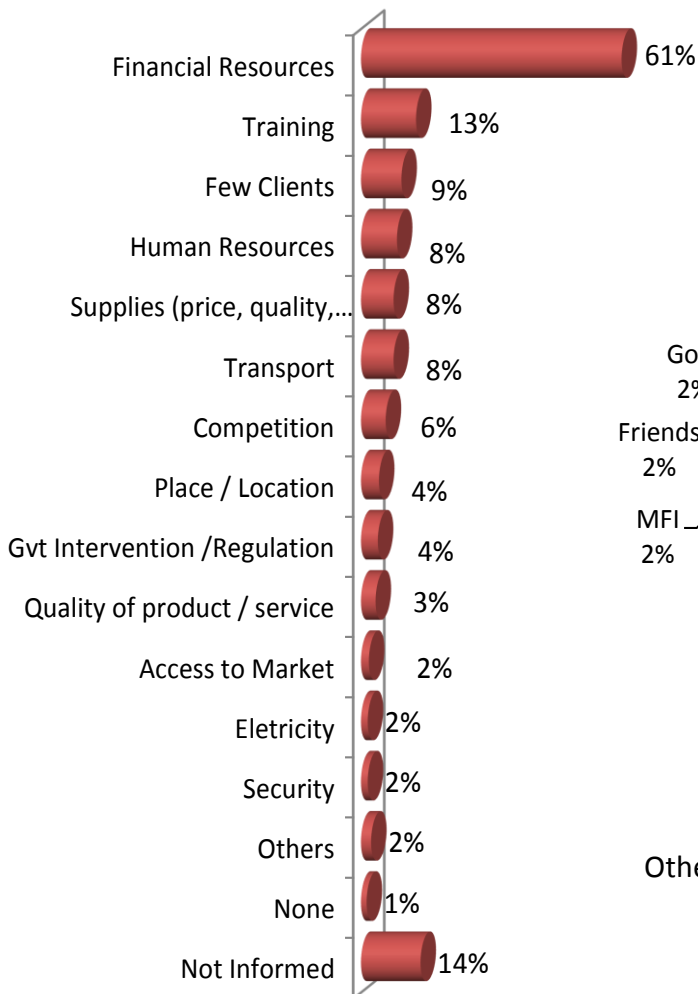
Number of Full-Time Employees



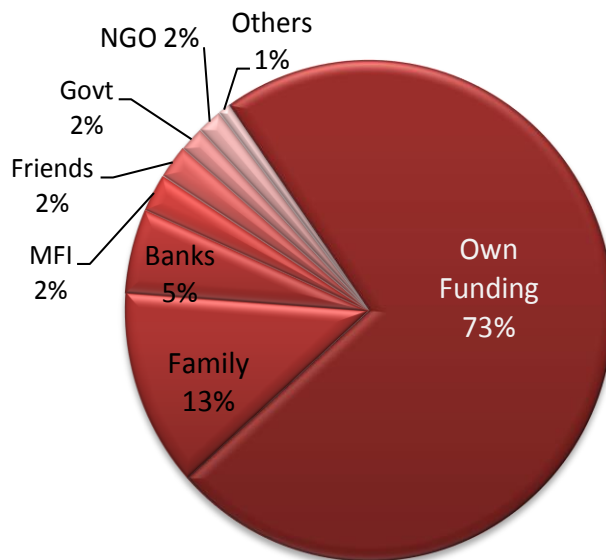
BUSINESS OWNERS: STARTING THEIR BUSINESSES

Main challenge when they started their businesses was none or insufficient financial resources. Most of them (73%) used only own funds, and started a smaller business and expanded slowly

**Challenges
(when started their business)**



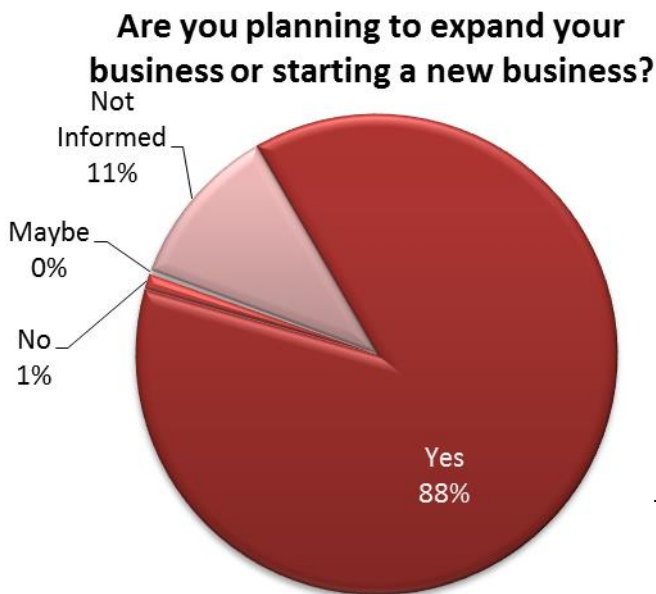
Source of Funding When Started Their Businesses



Others: Credit from Suppliers, Lottery Prizes

BUSINESS OWNERS: INVESTMENT PLANS & CHALLENGES

Limited financial resources continues to be the main challenge when planning to expand or to start a new business, followed by “training / knowledge/skills”. 88% mentioned they have a plan to expand or start a new business



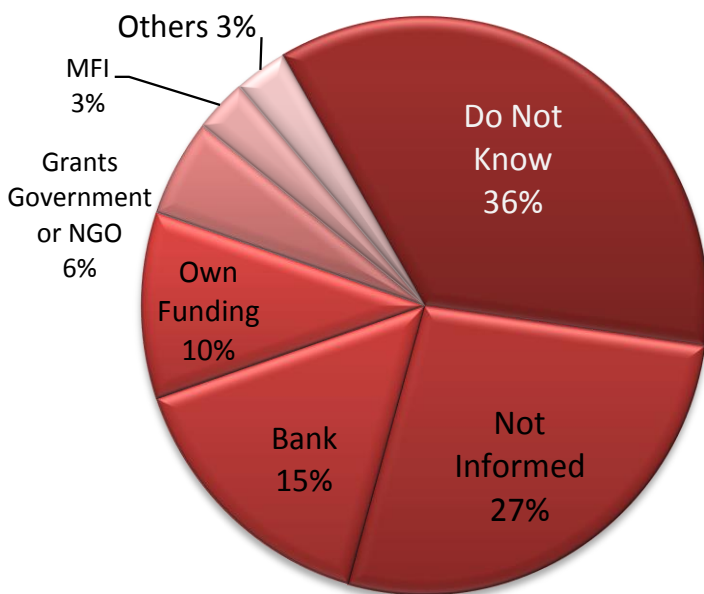
“I don’t know how to do a Business Plan. I would like to learn more about Finance and Management”

“Local employees have limited skills. There are too many holidays, they work few hours a day and are absent for too many days.”

BUSINESS OWNERS: FINANCIAL RESOURCES TO GROW

Despite ensuring they already planned to expand/start a new business, most of them have not defined the source of capital for the investment. Participants are very concerned about not being able to payback a loan in fixed instalments, and preferred to save money and start and grow their business slowly

How do you plan to fund the expansion / new business?



*Never thought about taking loans from banks, I am aware of loan details **from some friends**. There are **too many conditions...***

"No (I would not consider a bank loan); banks give loans to employees not to entrepreneurs"

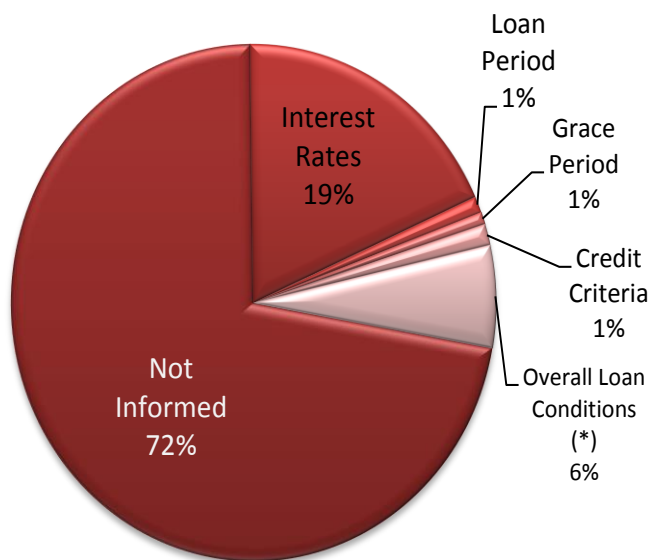
*"In Indonesian time, banks analysed clients' current account movement to approve loans. Now banks ask for all documents, prove of fixed/guaranteed source of income - this doesn't attend the large/medium entrepreneurs. **I have used BNU, ANZ and Mandiri, but banks do not provide a good service to entrepreneurs"***

Others: Friends, Family, Credit Union, Cooperatives, Partnerships, Competition Prizes

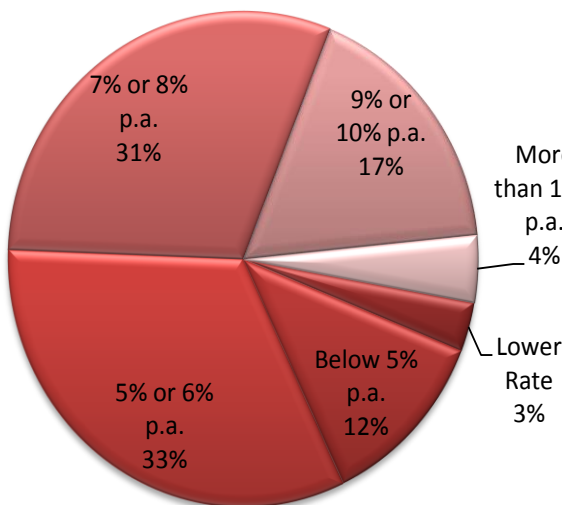
BUSINESS OWNERS: FAIR LOAN CONDITIONS

Despite complaints about loan conditions and interest rates, 72% did not inform what they consider to be "fair"

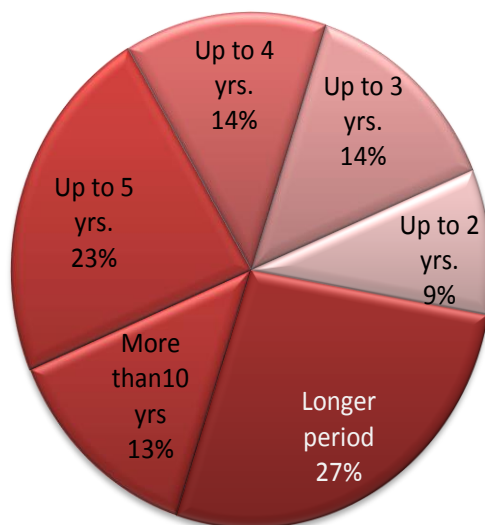
What would you consider "fair conditions" for loans?



"Fair Conditions": Interest Rates



"Fair Conditions": Loan Period



(*) Overall conditions: Interest Rates and other aspect (period, grace period, or credit criteria)

2.3. BUSINESS PLAN COMPETITIONS



BUSINESS PLAN COMPETITIONS

Business plan competitions are a recent initiative in Timor-Leste. Organizing institutions offer management training and technical support for business plan development. However, even the selected business ideas are not yet “investment ready”

The two main business plans competitions are:

- **IADE Innovative Business Plan Competition**
- **CCI-TL Innovative Business Idea Competition**

Both organizations (IADE and CCI-TL) offer trainings on management skills and business plan development for participants. They also offer technical support for entrepreneurs to develop their business ideas and business models. The competitions are a platform for entrepreneurs to find potential investors/partners to finance their business ideas.

Most participants have no experience in starting, managing or even working for businesses. So despite the trainings and technical support, most of the business plans need further improvement to be considered “investment ready”.



IADE INNOVATIVE BUSINESS PLAN COMPETITION

IADE promoted 2 editions of its “**Innovative Business Plan Competition**”, open to Timorese interested in becoming entrepreneurs and with innovative business ideas. Finalists receive a small prize money to continue the process to develop and launch their businesses.

IADE coordinates the “Centro de Desenvolvimento Empresarial” (CDEs – Enterprise Development Centres) activities in all 13 municipalities. Hence it receives participants from all over the country.

2013 Edition

- 285 participants, 30 participants were selected for training and business plan development
- 10 business plans selected for the national finals, in the following business areas:
 - Small industry (6)
 - Agriculture (3)
 - Services (1)
- Average requested investment of the 10 finalist projects: \$5,500 (according to their Business plans)
- Top 3:
 - 1st: Breeding Timor’s Poultry with Machine Incubator (Oecussi)
 - 2nd: The Creative Art of Miniature Clay Pot (Dili)
 - 3rd: Multiple Techniques of Massages and Reflexology by Blind People (Same)

2014 Edition

- 336 participants registered from all districts, 30 business ideas were selected for further development
- 11 business plans selected for the national finals, in the following business areas:
 - Agriculture (5)
 - Small industry (2)
 - Recycling (2)
 - Education (1)
 - Services (1)
- Top 3:
 - 1st: Healthy Herbal Tea from Figs (Dili), prize: USD 6,000
 - 2nd: Briquettes Easy to Use in the Kitchen (Baucau), prize USD 5,000)
 - 3rd: Fresh Sawi Fish (Manatuto), prize USD 4,000

Source: IADE website, <http://www.iade.gov.tl/en/blog/iade-realisa-audisi-final-kompetsisaun-plano-negosiu-inovativo/>, <http://www.iade.gov.tl/pt/blog/apresentasaun-e-resultadu-ikus-kompetsisaun-planu-negosiu-inovativo/>, [http://invest-tl.com/news-investment-timor-leste/150/16/en/innovative-business-plan-competition-usd\\$6000-00-for-the-first-winner.html](http://invest-tl.com/news-investment-timor-leste/150/16/en/innovative-business-plan-competition-usd$6000-00-for-the-first-winner.html)

CCI-TL INNOVATIVE BUSINESS IDEA COMPETITION



Supported by BFZ cooperation program, CCI-TL developed its “**Business Innovation Project**”. It includes a **business incubator for youth** (below 40 years of age) and the **Innovative Business Idea Competition**.

The competition was promoted in the main universities in Dili and its 1st edition of the competition has not been completed.

The project also originated the **National Association of Youth Entrepreneurs (ANJEU)**. ANJEU aims to increase youth contribution for the country economic development, promoting entrepreneurship. It offers trainings, orientation, and network for business ideas development. It also plans to open councils in all municipalities.

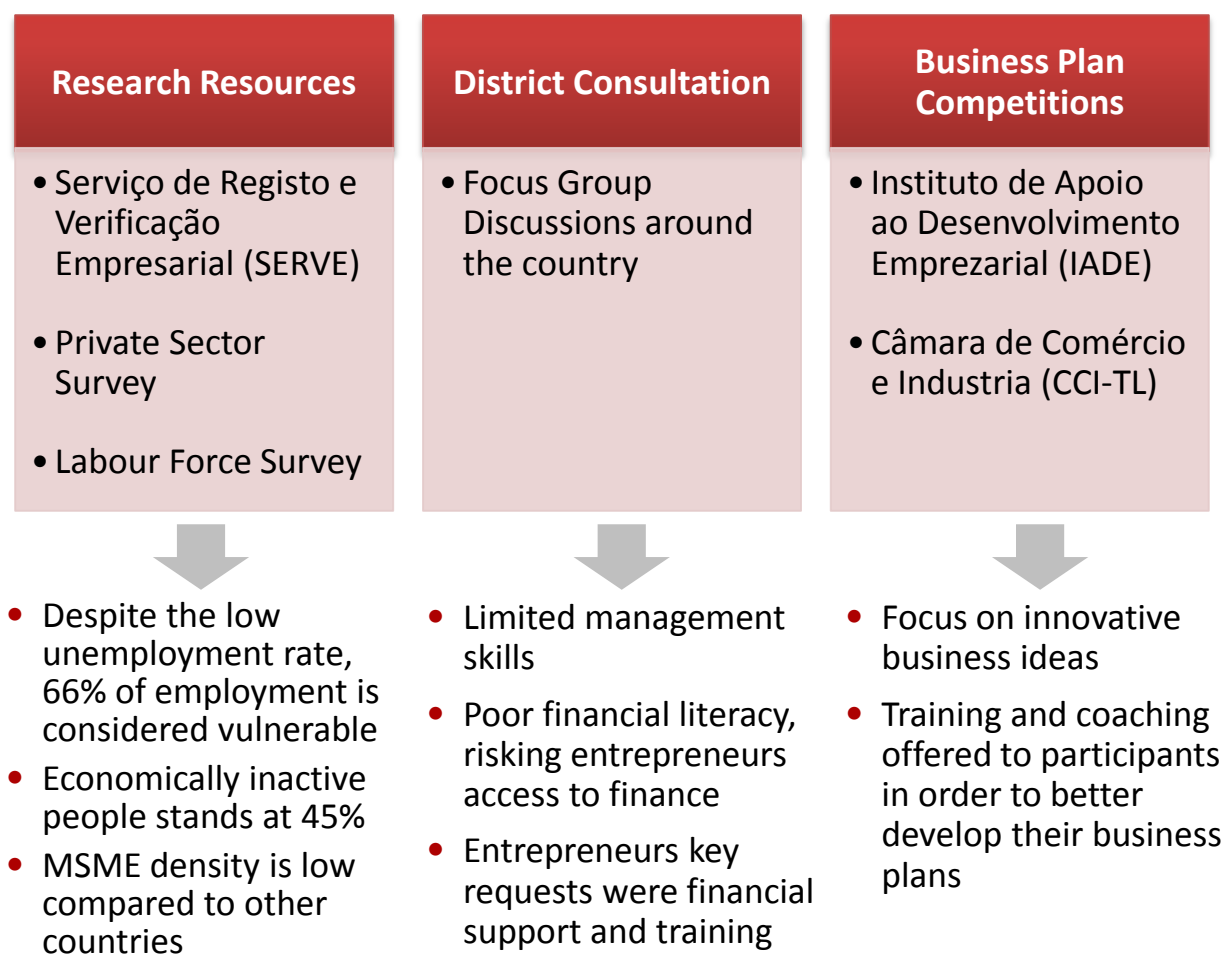
2013/2014 Edition (still in progress)

- Presentations in major universities and training centres in Dili (about 2,000 people attended)
- Training and technical support for business plan development (85 people attended)
- 16 business plans took part in the competition (around 50 people)
- Average project investment according to their business plan: \$ 33,000 per project
- Business plans in the following areas:
 - Agriculture (9)
 - Small industry (4)
 - Handcraft (2)
 - Commerce (1)

2.4. FINDINGS & RECOMMENDATIONS

SUMMARY OF DEMAND ANALYSIS

According to our survey, most people demonstrate intention to start or expand their business initiatives. However, management skills are limited, own funding is not enough, and business plans are not properly designed



KEY FINDINGS FROM DEMAND ANALYSIS

- **Unemployment rate is 9.8%** (15-64 years old), but the **economic inactive population stands at 45.3%** of the population from 15 to 64 years old (255,319)
- There are no precise data about companies operating in Timor-Leste, but data published indicates that **the MSME density is low** comparing to other countries
- **Participants in consultations are reluctant to form groups** in order to find partners to invest in business initiatives
- General complaints regarding loans are about **strict criteria for credit approval and high interest rates**
- All participants in focus groups would like to invest in their business (to expand or start a new one) – but prefer to start small with own funding or wait for a grant. Only very few participants have developed a business plan
- Business plan competitions aim to raise the knowledge around starting and managing businesses – but the process is just at the beginning, **management skills are still very basic**



Resistance to form groups, find partners

Strict criteria for credit approval



Basic skills

KEY RECOMMENDATIONS BASED ON DEMAND ANALYSIS



Social business values



Focus on Ideas and entrepreneur



Business incubator, technical support, and training

Many Timorese want to start (or expand) a business but they have no/limited access to finance to fund their ideas. The challenge is to identify viable business plans to invest and capable entrepreneurs. Below are the recommendations for the Social Business Fund:

- **Use as many channels as possible to identify potential social business ideas** – existing business plan competitions (reach all municipalities), procurement process...
- **Focus as much on the idea as on the entrepreneur.** Selection must take into account the entrepreneur’s skills, potential, and motivation, as well as the potential business model
- Address entrepreneurs’ key concerns regarding finance, **offering low interest rates, extending loan periods and grace periods**
- **Offer technical support specific for each business idea** – in order to increase success of a business initiative, specialised management and technical advisory is essential (including on marketing strategy, quality standards, access to market)
- **Create a Social Business Incubator & Accelerator**– it would help entrepreneurs to develop the full “social” potential in their business ideas
- **Require beneficiaries to attend management courses** – sound management skills and financial literacy are essential for any business activity to succeed
- **Focus on a few initiatives** – despite the apparent large demand for funding, it will be necessary to invest a lot of time, energy and resources to develop business ideas and entrepreneurs for success

3. SOCIAL BUSINESS FUND: ADMINISTRATIVE ARRANGEMENT

“One dollar given for charity has only one life, one dollar invested in a social business can be reinvested several times” - Prof. Muhammad Yunus

Section Content:

- 3.1. Benchmarking of Social Business Funds
- 3.2. Social Businesses in Timor-Leste
- 3.3. Social Business Fund Design
- 3.4. Sustainability Strategy

ADMINISTRATIVE ARRANGEMENT

Based on the district consultation, “access to finance” is the main challenge entrepreneurs encounter when they want to start or expand a business. In order to create a more conducive environment for SMEs, facilitating loans to SMEs is essential, hence the Social Business Project plans to **setup a lending facility to finance SMEs**.

As mentioned in the previous chapter, **providing technical and management skills training** is as important as the access to finance to improve SMEs chances to succeed. Also, improving entrepreneurs skills and business plans will facilitate the application and credit evaluation process for getting a loan.

This chapter analyses Social Business Funds operating in other countries to find best practices, and recommends a structure to setup a lending facility adapting these best practices to the Timor-Leste context.

The Social Business Funds analysed are:

- Yunus Social Business Fund
- Big Society Capital
- Liverpool City Region Impact Fund
- Ontario Catapult Microloan Fund for Social Enterprises

The recommendation for the lending facility administrative arrangements will cover the following topics :

- What would the Fund actually finance
- How would the Fund be managed and governed
- How would the Fund be structured

The report concludes with final recommendations and next steps to setup the lending facility.

3.1. BENCHMARKING OF SOCIAL BUSINESS FUNDS

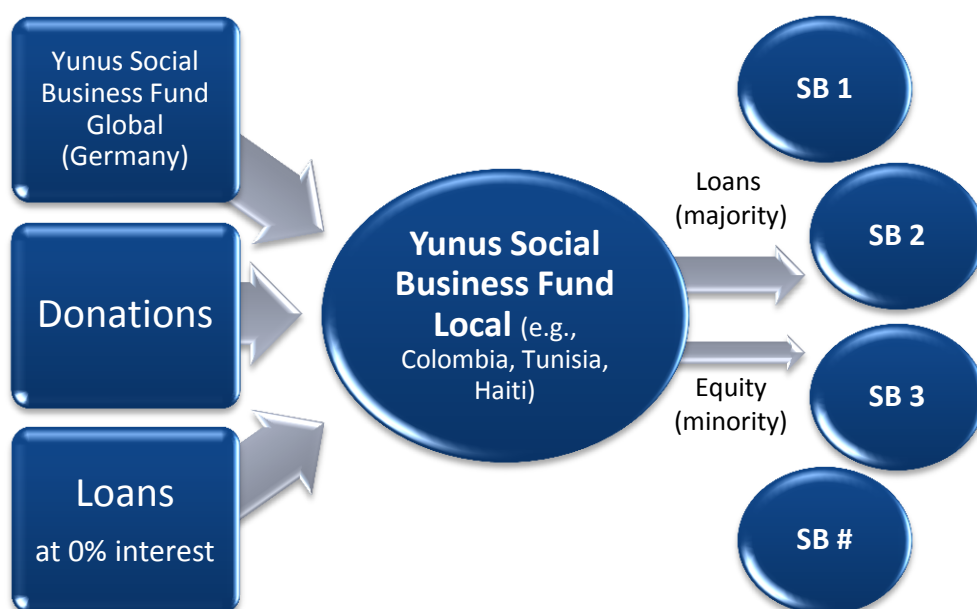
Analysis of similar Funds to learn best practices from key players in the field:

- Yunus Social Business Fund
- Big Society Capital
- Liverpool City Region Impact Fund
- Ontario Catapult Microloan Fund for Social Enterprises

YUNUS SOCIAL BUSINESS FUNDS

Yunus Social Business Fund (YSBF) is the most renowned Social Business Fund. It is an initiative to provide start up capital to social businesses. It also “connects investors with social businesses, giving them the opportunity to help solve social issues in a self-sustainable way.”

- **Fund Format:** Global Fund and local funds in each of the countries it is operating in (e.g.: Colombia, Tunisia, Haiti, etc.). In Brazil, the local fund will be managed by an asset management institution, as an investment fund. The format is defined based on local regulations
- **Fund Sourcing:** Capital injection from Yunus Social Business Global Fund, donations and loans at 0% interest rates
- **Operation:** Based on local regulations, transactions are not legally “loans” to avoid the classification and regulation as “financial service provider”; instead, they are contracts for the exchange of fixed amounts in defined periods of time. Contracts also include an equity component to guarantee YSBFs participate in important decisions and the business continues to be a “social business”
- **Fund Sustainability:** interest of 6% to 8% per annum is charged from borrowers, the interest revenue is used to cover administration costs and potential credit losses



Source: Call with YSBF CEO & Co-Founder Saskia Bruysten (26 June 2014) and YSBF website

Contract Details

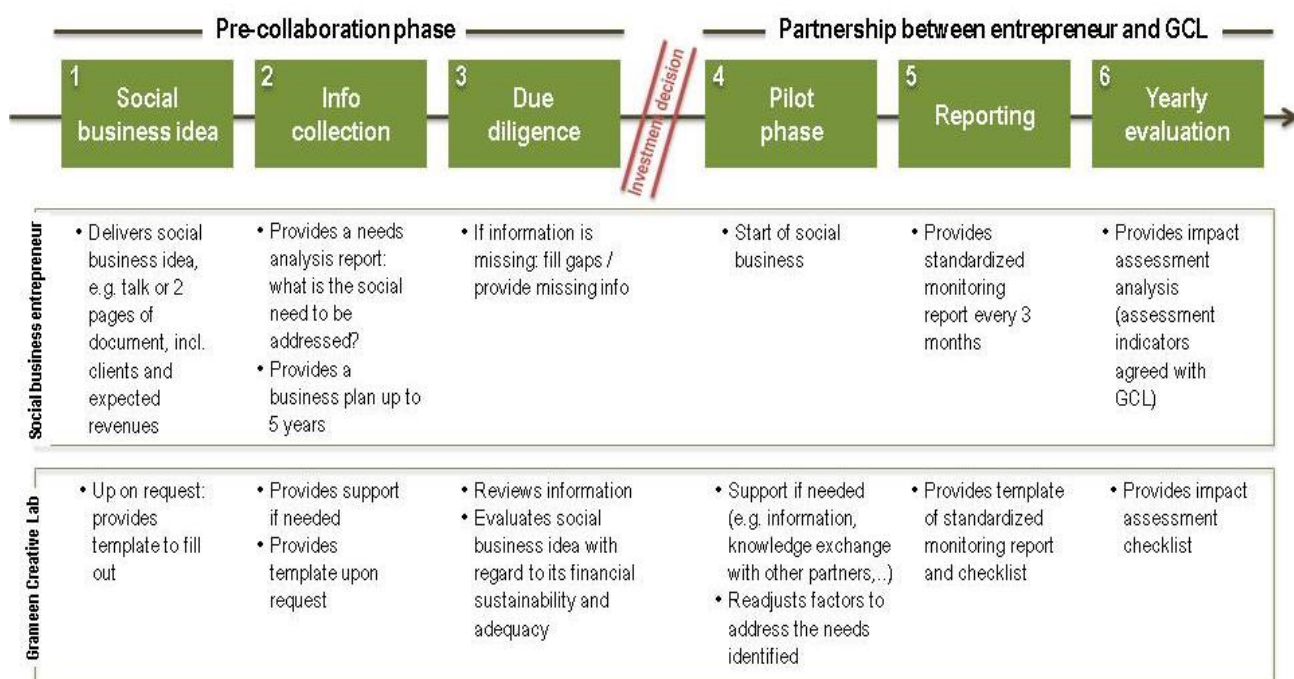
- Matching Fund/Self-Funding from the entrepreneur is ideal, not a requirement
- Consultancy service offered to develop business ideas into investment-ready stage
- Selection process for investment-ready business to be supported through:
 - Business ideas competitions
 - Organizing events (e.g., forum, training on social business, etc.)
 - Accelerator programs: 2 months of training to better develop their business models
- Contract Size: varies according to the country (Haiti: from \$50K to \$500K)
- Investment period: 8 years
- Business consultancy offered during the loan period to guarantee the business success and, if necessary, revise the “loan” contract, to minimize losses

YSBF Operation

- 1+ year to set up the fund structure
- Requires USD 5 million capital for partnership with YSBF Global
- Fund sustainability is achieved with USD 10 million capital
- YSBFs also provide consultancy to setup other social business funds

Recommendations from YSBF Global

- **Start small and test the “format”**
- **Select business models that work, not just social ideas**

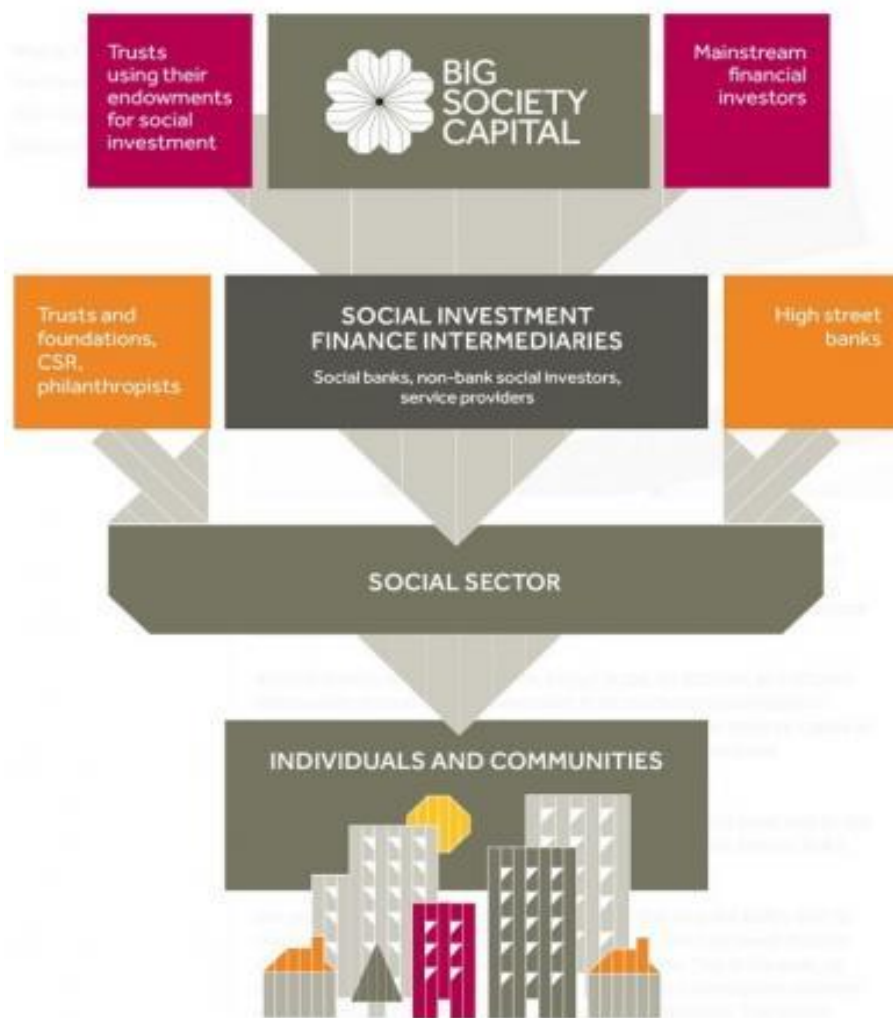


Source: Call with YSBF CEO & Co-Founder Saskia Bruysten (26 June 2014) and YSBF website

BIG SOCIETY CAPITAL

Big Society Capital is a social investment bank created by the United Kingdom government. “It operates **independently, developing a diverse and sustainable social investment market**. It aims to offer social and financial returns”

- **Fund Sourcing:** Funds left in dormant bank accounts and investments from largest banks
- **Operation:** “Invests in social investment finance intermediaries (SIFIs). SIFIs provide, facilitate or structure financial investments for social sector organisations and/or provide investment-focused business support to social sector organisations”
- **Fund Sustainability:** Achieved through its own returns, and ongoing injections from dormant bank accounts



Source: The Big Society Capital website, <http://www.bigsocietycapital.com/>
The Economist, “Big Society Capital: Funding a dream”, <http://www.economist.com/node/21551528>

BIG SOCIETY CAPITAL

Selection Process (from the website):

1. Organizations interested in support must complete the “**expression of interest**” form, with information about the organisation, what type of investment, how much and for what
2. If approved, they fill a complete **application form** to be evaluated by an internal investment team. The evaluation analyses the full business plan and financial model, the social mission statement, and information about the management and governance structures
3. If successful, Big Society Capital completes a **due diligence** for final decision. The due diligence includes a visit to the offices, interviews with key staff and Board members, scenario testing of financial projections and a review of the social impact reporting

Organizations they support:

- Community Investment Fund: Finance for community organizations
- DWP: Supporting vulnerable teenagers
- FSE Group: Renewable energy in deprived areas and Finance for charities
- Social Stock Exchange: Developing market infrastructure
- ClearlySo: Social enterprise infrastructure
- IAAM: Improving adoption placements
- Resonance: Affordable home rentals for local people
- Big Issue Invest: Helping the financially excluded
- Bridges Social Impact Bonds: Finance for payment-by-results

EMERGING INVESTABLE OPPORTUNITIES IN THE SOCIAL INVESTMENT MARKET



Source: The Big Society Capital website, <http://www.bigsocietycapital.com/>

The Economist, “Big Society Capital: Funding a dream”, <http://www.economist.com/node/21551528>



BIG LOTTERY FUND

“The Big Lottery Fund is a non-departmental public body sponsored by the Cabinet Office. It is accountable to Parliament, the devolved legislatures and the Government.

In 2013/14 it distributed £670 million of new awards to 12,000 projects (£2 million per day). 92% of these awards went to voluntary and community organisations. The majority of the awards (88%) were for less than £10,000 – most of them to small local groups. Funding from £300 upwards is available – allowing grassroots groups to turn their ideas into reality.”

The Big Lottery Fund manages different funds with different focuses. Below are two funds focused on supporting social businesses:

Social Incubator Fund

£10-million fund to support the development of more social start ups across England, managed by the Big Lottery Fund. It provides support to companies that help develop and grow social start ups and social entrepreneurs.

The Social Incubator Fund provides grants to social incubators, “a portion of which forms an investment book which must be invested in social ventures using non-grant financial structures”.

“The fund aims to increase the amount of money available at the early stages of projects where the financial return is too low and/or the financial risk is too high for Big Society Capital and other investors.”

Social Outcomes Fund

£20-million fund for social impact bonds (SIBs) or payment-by-results (PbR) projects addressing complex and expensive social issues.

“It is intended to deal with the main problems holding up the growth of social impact bonds: the difficulty of aggregating benefits and savings which accrue across multiple public sector spending ‘silos’ in central and local government.

By paying for outcomes, the fund will hopefully make it possible for new and creative solutions to social problems to develop. It will also create new evidence about what types of intervention work and how the outcomes of projects can be effectively measured.

An important aim of the fund is to collect an evidence base on what currently stops the growth of SIBs. Reporting and assessment of performance data is a condition of all funding, and will create evidence on how effective the project is and help to ease any future problems. This data will also form an evidence base of benefits that build up across government departments to encourage cross-government working.”

Source: http://www.sibgroup.org.uk/fileadmin/tsib_users/Our_Funds/LIF/LCRIF_fund_guidelines_2014_1_0_Updated_18_12_14.pdf, <https://www.gov.uk/government/policies/growing-the-social-investment-market>, and <http://www.sibgroup.org.uk/liverpool-lif/>

LIVERPOOL CITY REGION IMPACT FUND



The **£2-million** Liverpool City Region Impact Fund offers **finance to charities and social enterprises** based in the Liverpool City Region

Fund Donors

- Social Investment Business (SIB) Foundation's Community builders Fund (£1 million)
- European Regional Development Fund (ERDF) 2007-13 programme (£1 million)

Objective of the Fund

- Develop, grow and increase their community and economic impact
- Develop and expand trading activities so that they can become strong and sustainable and achieve financial sustainability for themselves – e.g. enable capital purchase/refurbishment, support bidding for and winning new contracts and other sales activity
- Safeguard existing jobs, support the creation of new jobs and increase in organisational turnover.

What does the fund offer?

- Unsecured loans of between £50,000 and £250,000
- To charities and social enterprises in the Liverpool City Region
- Repayment period of up to 5 years
- Interest rate of 6-12%

“It is a 10-year fund with two waves of investments of up to 5 years. The first wave of investments will be made in 2014. A second wave of investments will be made in 2017-2019 from the returns on the first wave.”

“At the end of the 10-year period 50% of the remaining funds will constitute a legacy for social enterprises in the Liverpool City Region, which will allow further investments into locally based social enterprises.”

Source: http://www.sibgroup.org.uk/fileadmin/tsib_users/Our_Funds/LIF/LCRIF_fund_guidelines_2014_1_0_-_Updated_18_12_14.pdf and <http://www.sibgroup.org.uk/liverpool-lif/>

ONTARIO CATAPULT MICROLOAN FUND FOR SOCIAL ENTERPRISES



“The Ontario Catapult Microloan Fund for Social Enterprises is a collaboration between the government, businesses, and non-profits to **support social innovators and entrepreneurs working across sectors in food security, youth civic engagement, chronic disease prevention, etc**”. It is a partnership between:

- **Government:** Province of Ontario
- **Social Business Promotion Organization:** Centre for Social Innovation (CSI)
- **Other Donors:** Alterna Savings (Financial Institutional partner – loan operation), Microsoft Canada, TD Bank Group, KPMG, and Social Capital Partners

“The Fund is managed by CSI and an appointed review committee comprised of CSI’s partners and independent experts,”

Eligibility Criteria:

- Ontario-based and member of the Centre for Social Innovation
- Less than 25 full-time employees and annual revenue under \$2 million
- Pursuing a sustainable, income-generating business activity
- Addressing a social, environmental, economic, or cultural challenge

Provides:

- A range of support to enable social ventures succeed
- Low-interest loans of \$5,000-\$25,000
- Term: up to a maximum of five years
- Rate: 5% to 8% (depending on the business and credit history)
- Payment schedule: first payment within 30 days after the initial disbursement
- Fees: \$100 administration fee that can be incorporated or deducted from the loan and \$15 one-time Alterna Savings membership

Application process includes: Business Plan, Social Impact, Innovation, Marketing Plan, Reason to Believe/Credibility, Financial Projections

Request: Enterprises to undertake a full impact assessment of the investments over a 2-year period

Source: <http://www.canadabusiness.ca/eng/program/4274/>, <http://www.canadabusiness.ca/eng/program/4869/>, and <http://socialfinance.ca/2013/11/11/ontario-catapult-microloan-fund/>

NEW ZEALAND GOVERNMENT SUPPORT TO SOCIAL ENTERPRISES

“The New Zealand Community and Voluntary Sector Ministry announced **\$1.27 million** investment in the development of a solid support infrastructure for **emerging social enterprises**, defined as Organisations with social or environmental goals which use commercial models to generate income”.

The government recently launched two initiatives:

1. Social Enterprise Incubation and Development Service

Hikurangi Foundation (charity focused on supporting start up social enterprises) will receive \$1.12 million to “help build a national social enterprise incubation and development service to provide expert support, resources, and one-on-one advice.”

2. Social Enterprise Accelerator Pilot

“Grant to fund an accelerator pilot to support 10 social enterprise initiatives”. It is a partnership between:






- **Government:** Community and Voluntary Sector Ministry
- **Social Business Promotion Organization:** Hikurangi Foundation
- **Other Donors:** Contact Energy (private sector)

Source: <http://www.beehive.govt.nz/release/government-gets-behind-social-enterprises> and [http://www.dia.govt.nz/Pubforms.nsf/URL/SocialEnterpriseSOCPaper.pdf/\\$file/SocialEnterpriseSOCPaper.pdf](http://www.dia.govt.nz/Pubforms.nsf/URL/SocialEnterpriseSOCPaper.pdf/$file/SocialEnterpriseSOCPaper.pdf)

COMPARATIVE ANALYSIS

Among the analysed Social Business Funds, only Yunus Social Business Fund is not related to the government. **Government participation in the funds varies, from donor to catalyst of social business** (Ontario Catapult Microloan Fund), showing government interest in incentivising civil society to develop sustainable business models that are able to tackle social issues.

Most Social Business Funds offer **soft loans*** (except the Big Lottery Funds) and **technical support**, hence social businesses must prove their economic sustainability.

	 Yunus Social Business Fund	 Big Society Capital	 Social Incubator Fund	 Social Outcomes Fund	 Ontario Catapult Microloan Fund
Beneficiaries	Social Business (Yunus definition)	Social Investment Finance Intermediaries (SIFIs)	Social Business Incubators	Social Business/ Project (able to measure social outcomes)	Income-generating businesses (focused on social, environmental, economic, or cultural challenges)
Type of Support	Soft Loan, Incubator and Technical Support	Soft Loans	Grants	Social Impact Bond (payment by results)	Soft Loan and Technical Support
Institutional Arrangements	Based on local regulation. Normally as an independent foundation in the countries	Independent Social Investment Bank (funded by government decree)	Non-departmental Public Body	Non-departmental Public Body	Collaboration of government, business, and non-profits. Managed by the Centre for Social Innovation and independent experts

* Soft Loans are loans with special conditions, such as lower interest rates, grace periods, easier credit requirements.

3.2. SOCIAL BUSINESSES IN TIMOR-LESTE

Summary of Social Business initiatives in Timor-Leste and alternative ways to incentivise new projects

- Existing Social Enterprises
- Promotion of Social Business

SOCIAL ENTERPRISES IN TIMOR-LESTE

Most organizations established to solve poverty issues in Timor-Leste follow the NGO/charity model (i.e., funding their operations mostly through donations), but some of them have started to develop other sources of funding, applying the social business concept, such as:

- **Casa Vida** (operates the Kafe Aroma restaurant, Doce Vida coffee shop, and Arte Vida handcrafts production)
- **Mos Bele** Project in Maubara (operates a restaurant, Tasi Café, handcrafts and food processing)
- **Empreza Di'ak** (provides support to establish small community businesses, and also to develop their value chain)
- **SOLS 24/7** (provides training, charging fees for their services to cover internal costs, and through paid projects for the government and other clients)
- **Peace Coffee** (coffee shop to promote coffee from Timor-Leste in South Korea and to offer affordable coffee drinks for locals; it's a YMCA initiative)

A Social Business Fund would facilitate social SMEs access to finance, but that is not the only way to support Social Business. **Other ways to promote Social Business include to:**

- Select high-potential Social Business Plans to support with grants and mentoring
- Select and support NGOs to become Social Businesses, aiming to expand their impact
- Promote events to disseminate the Social Business concept and create an ecosystem
- Organize Social Business Bootcamps to increase awareness and skills
- Improve business management in training centres (IADE, Institute of Business - IOB, Universidade Nacional Timor Lorosa'e - UNTL)
- Create a matchmaking marketplace for Social Business initiatives and potential investors
- Create a Social Business Plan Competition
-

SOCIAL BUSINESS FUND IN TIMOR-LESTE

According to the UNDP project, the **Social Business Fund is a critical element to promote social businesses**. But implementing a Social Business Fund will require:

- **Funding the management structure**

In the first moment, costs from the Fund management will need to be covered from additional support. Consuming the Fund to cover expenses will jeopardize its long-term sustainability.

Once the Fund reaches a certain amount of capital, the revenue (from interests) may be able to cover the Fund's own expenses (Yunus Social Business Funds aim for \$10 million of capital, generating returns of 6 to 8% per year).

- **Donors and partners time**

The Social Business Fund project doesn't end with the Fund implementation. On the contrary, the Fund will demand time from donors and partners for meetings regarding selection of initiatives to support, new partnerships and major decisions related to the Fund management.

- **Long-term commitment**

The Fund will support long-term initiatives, with 5-10 year-long contracts. It involves patient capital, very illiquid.

- **Flexibility and creativity**

Development of social businesses will require significant trial-and-error to design innovative solutions to achieve successful business models; it is a continuous-learning experience.

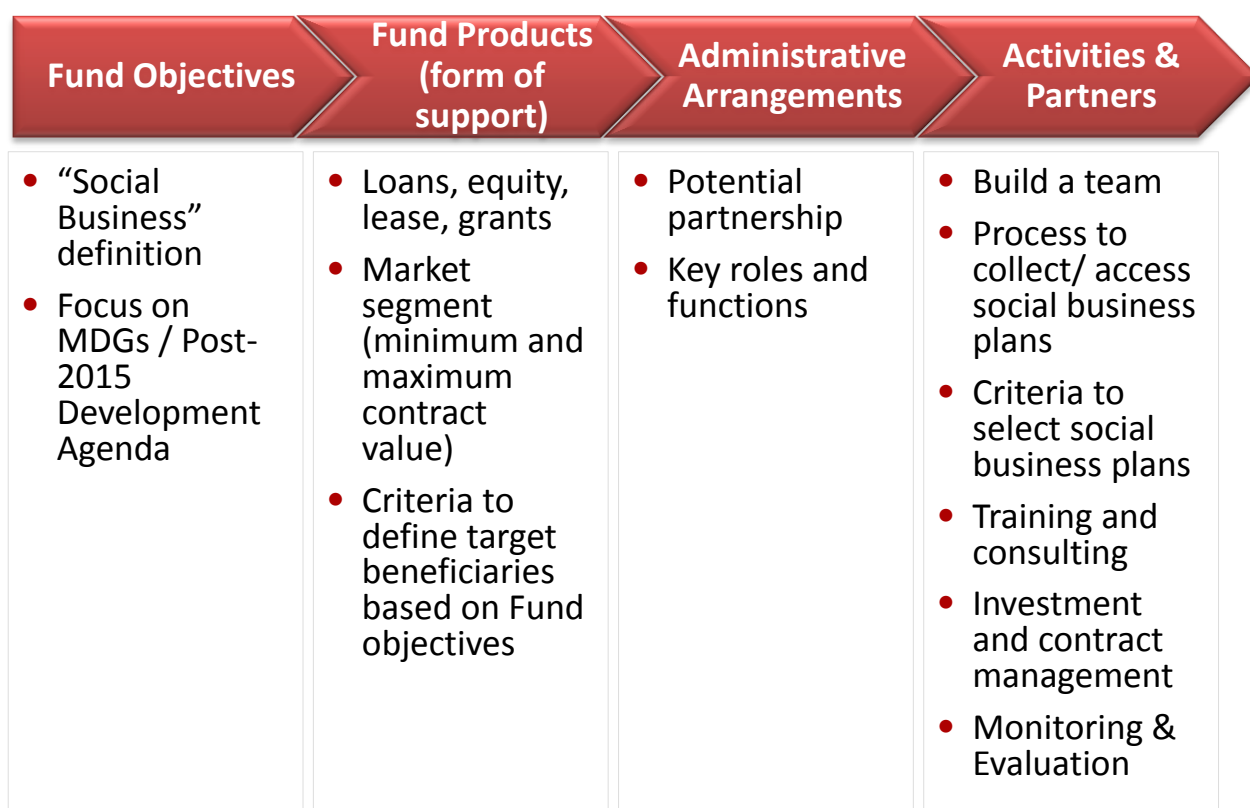
3.3. SOCIAL BUSINESS FUND DESIGN

Key decisions to establish the Social Business Fund:

- Fund Objectives
- Fund's Product
- Administrative Arrangements
- Activities and Partners

FUND ESTABLISHMENT

The key topics to establish a Social Business Fund are analysed in this section: the Fund's objectives, its form of support, administrative arrangements, and key activities and partners.



SOCIAL VS FINANCIAL FOCUS

To help understand the concept of Social Business, where the Fund is focusing on, the figure below represents a spectrum of organizations ranging from the ones primarily focused on social value to the ones focused on creating financial value.

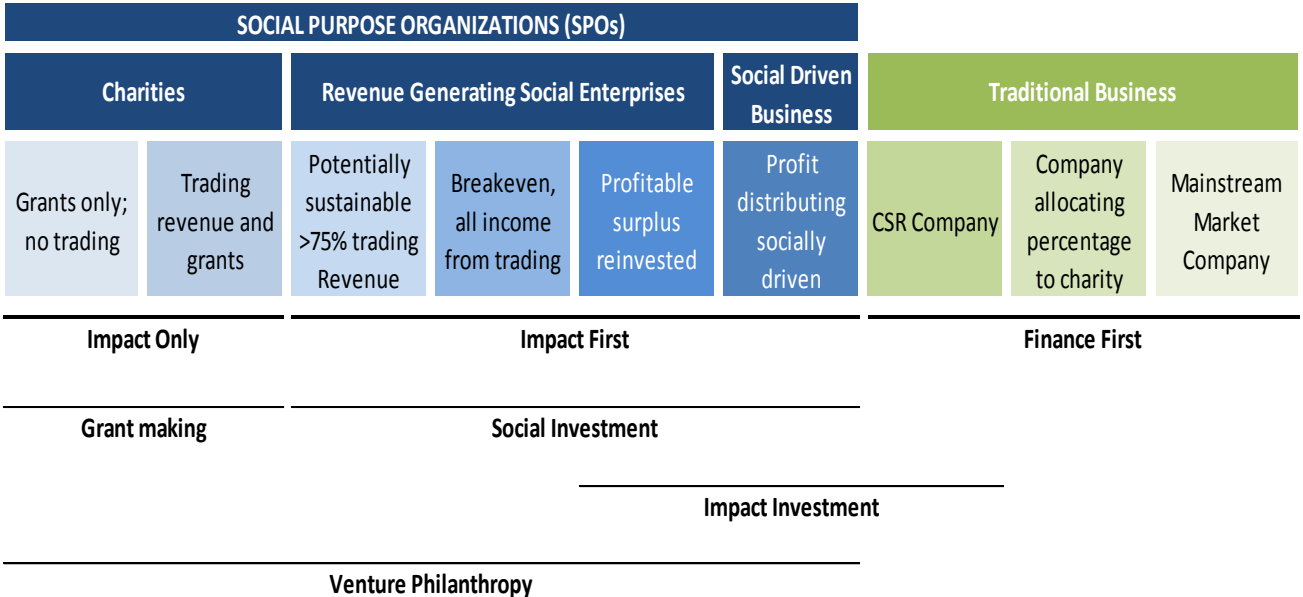
Social Businesses are located somewhere in the middle of the two types, as they have characteristics of both:

Social Businesses

Primary driver is to create social value

"Blended" societal and financial value

Primary driver is to create financial value



Source: Shaerpa and EVPA (INSEAD Social Entrepreneurship Programme)

YUNUS' SOCIAL BUSINESS DEFINITION

The 'Seven Principles of Social Business' as defined by Prof. Muhammad Yunus offer a reference to help propose the Fund's definition of Social Business:

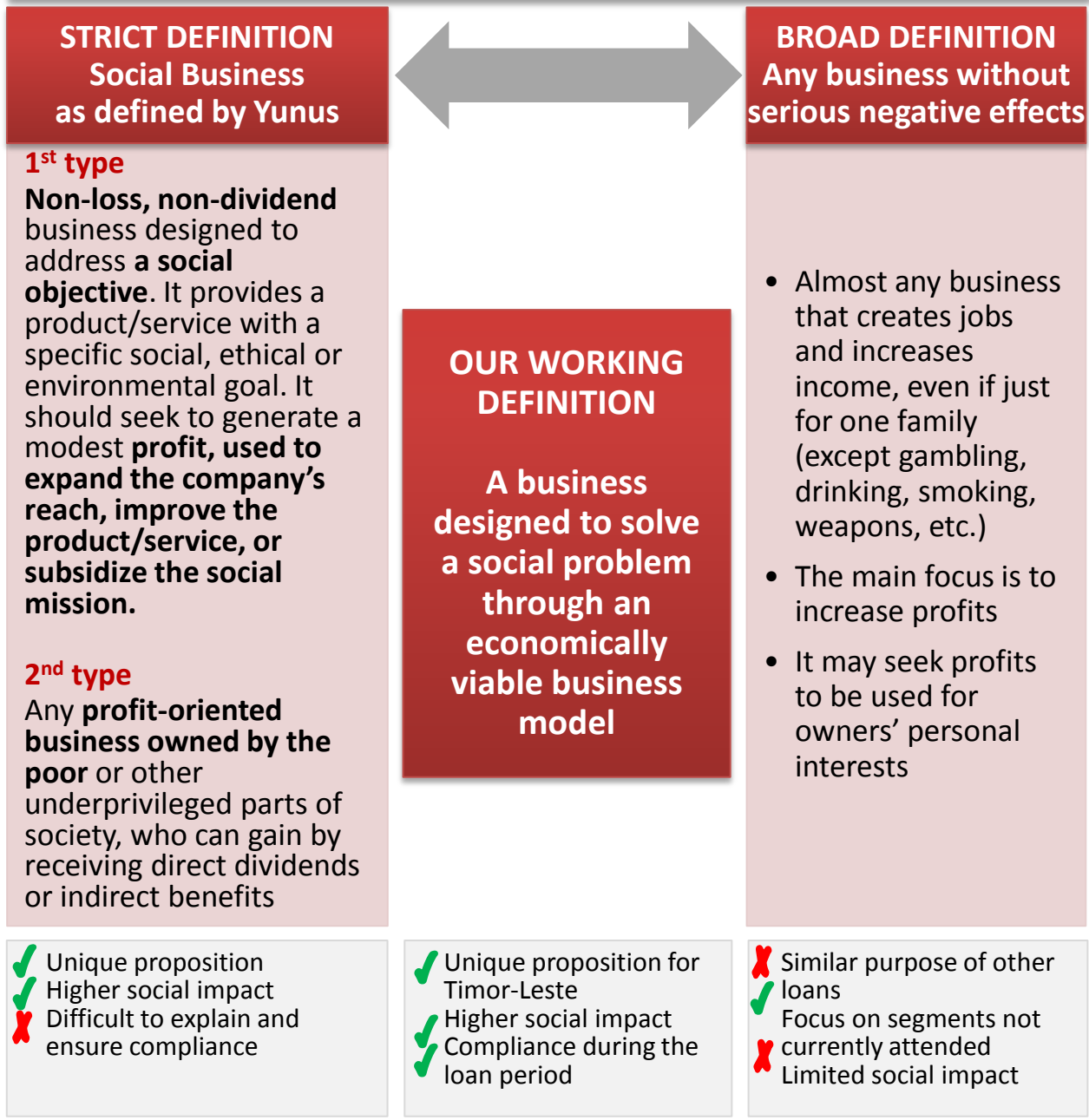


7 Principles of Social Business defined by Prof. Muhammad Yunus

1. Business **objective will be to overcome poverty**, or one or more problems (such as education, health, technology access, and environment) which threaten people and society; not profit maximization
2. **Financial and economic sustainability**
3. Investors get back their investment amount only. **No dividend** is given beyond investment money
4. When investment amount is paid back, company **profit stays with the company for expansion and improvement**
5. **Environmentally conscious**
6. Workforce gets **market wage** with better working conditions
7. **...do it with joy**

OUR SOCIAL BUSINESS DEFINITION

The Social Business Fund’s unique value proposition: to support social businesses in segments that are not attended by current financial services providers (small and medium-sized start ups), maintaining the focus on MDGs/Post-2015 Development Agenda



Source: Social Business as defined by Yunus: <http://www.muhammadyunus.org/index.php/social-business/social-business>

FORMAT OF FINANCIAL SUPPORT

The Social Business Fund could support organizations through grants, loans, payment by results, lease (loans for fixed assets acquisition), and buying shares (partial ownership). The table below highlights the advantages and disadvantages (from the Fund point of view) of these forms of financial support.

	Grants / Donations	Shares (Equity)	Lease	Loans (Debt)
	Provide grants to selected entrepreneurs. Entrepreneurs are not required to pay back/ return the financial support received	Provide capital in exchange for a share of the SME; ownership based on the proportion of capital invested by the entrepreneur and the Fund	Rental of equipment or properties with possible transfer of ownership at the end of the contract, when entrepreneur pays all contract instalments	Provide standard loans with or without interest rate. Entrepreneur is required to payback the loan
Advantages	Easier to manage (just transfer)	Entrepreneur can buy the shares back based on the business performance - flexible payment conditions Reduced credit risk (business ownership as guarantees) Investment expected to be recovered	Credit risk is reduced due to the assets ownership Easier to ensure the usage of the financial support Investment expected to be recovered	Product already offered in the market - legal aspects are defined Investment expected to be recovered
Disadvantages	Not financially sustainable (capital is not recovered) May create entrepreneur dependence on grants – doesn't test the business models it supports Not sure how the grant would be used	Limits entrepreneur's empowerment Business liabilities are also shared No market to trade equities in Timor-Leste	No active second-hand market for fixed assets Just for fixed assets , but business needs financing for other expenses also	Credit Risk Operational activity to charge and receive instalments payments

Other options in developed financial markets are: Pooling (securitized loans), Social Impact Bonds

Source: <http://southafrica.smetoolkit.org/sa/en/content/en/2625/Types-of-finance-available-for-SMEs>

FUNDING FORMATS

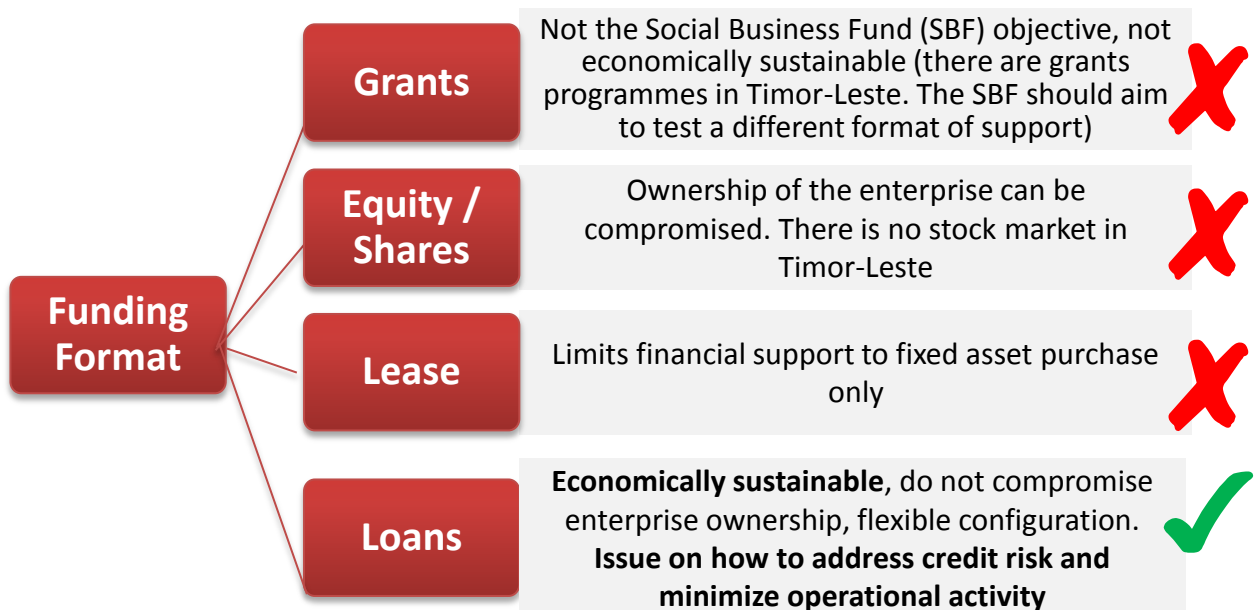
Grants are, operationally, the easiest way to finance social businesses, but giving grants would compromise the Fund economic sustainability. Grants do not test the business model (profitability) and potential for scaling up the impact.

Lease restricts the amount an enterprise can borrow, as the financing covers only fixed assets, not other types of investments and expenses.

The Fund could also invest in **equities** from enterprises it supports, but the Fund participation on the business should be minimal, in order to maintain the entrepreneurs' empowerment and ownership. With a minority participation on the businesses the Fund supports, the Fund could participate in strategic decisions.

Loans would offer more **flexibility in terms of the amount to be financed and how it can be used**, but also implies that the Fund is assuming the **risk of credit losses**.

The figure below summarises the major considerations and drawbacks for each of the funding format.

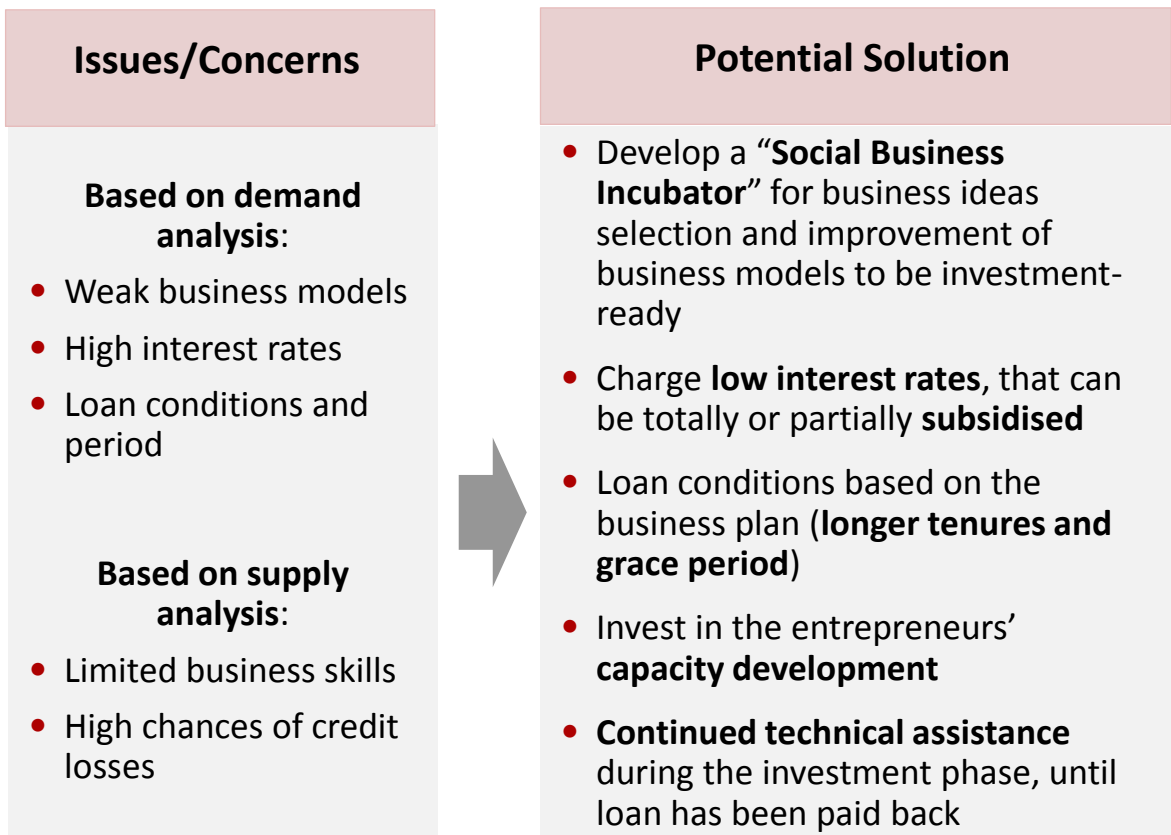


There are different forms to finance a Social Business.
Best practices in the sector and Timor-Leste context **suggest loan or a blended solution with loan and shares** (small participation)

SOFT LOANS AND TECHNICAL SUPPORT

Based on the information collected for the supply analysis, loan suppliers are concerned about entrepreneurs’ ability to understand their obligations and their ability to payback the loan. On the demand side, entrepreneurs are also concerned about the loan criteria and conditions (interest rate, period, etc.), and the unstable results from their business.

Loans with **lower interest rates and extended period for repayment (soft loans)** would address entrepreneurs’ concerns, while offering **training and technical support** to improve business plans and entrepreneurs’ management skills would increase the chances of success for their enterprises, and reduce lenders’ concerns.



Loans with low interest rates and grace periods would be attractive for entrepreneurs. Loans with loan guarantees, capacity development and technical support would reduce credit risk and increase entrepreneurs’ chances of success

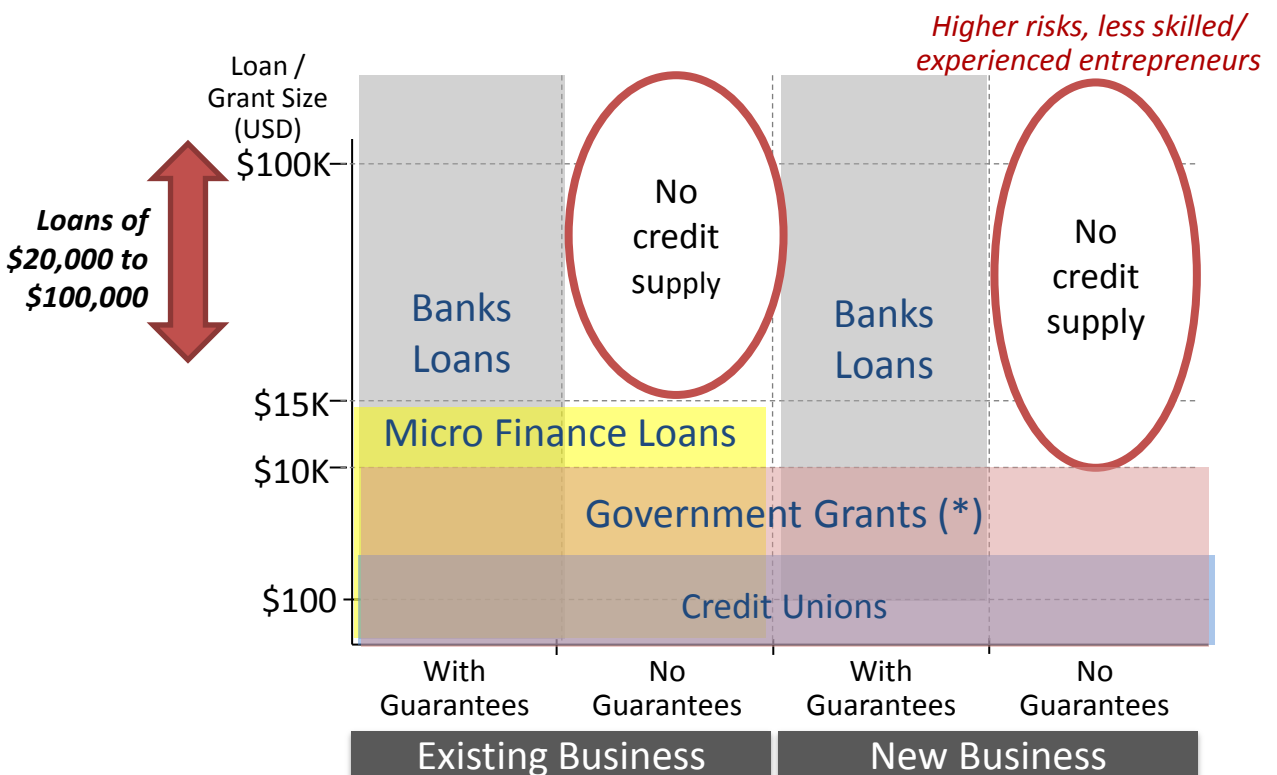
TARGET SEGMENT (FROM SUPPLY ANALYSIS)

Based on the supply analysis, the Social Business Fund should target the segments that currently have no access to credit and comply with the working definition of Social Business. These segments are not attended by lenders because they are associated with high credit risk and less experienced entrepreneurs.

The objective of the Social Business Fund is not to compete with current lenders, hence its target is **small and medium entrepreneurs with no or limited guarantees/collaterals**.

The Fund should not focus on micro-businesses, as there are several options for micro-business financing (microfinance institutions, credit unions, government micro-grants) and serving micro-businesses requires significant management relatively to the small capital they may need.

Focus on entrepreneurs of small and medium sizes that cannot be served by the current financial market: **loans of \$20,000 to \$100,000**



(*) Government grants based on the ministries' and secretaries' programmes (sector, activity, location)

FUND PRODUCT: LOAN DETAILS

The Social Business Fund could support selected entrepreneurs through soft loans, based on the details below:

Target Segment: **Small- and medium-size social businesses** that are not served by the current financial market. Social business is a business designed to solve a social problem through an economically viable business model

Loan Amount: **From \$20,000 to \$100,000** – ideally the entrepreneur would partially invest own-funds in the project (matched funding). **No additional loans from other organizations**, at the risk of increasing the credit default rates (as incentives are to pay the high interest rate loans first)

Tenure: Defined based on the business plan presented – ideally **between 1 and 3 years**, no longer than 5 years

Grace Period: Defined based on the business plan presented. The grace period should be **limited to the investment phase**; once the business starts to operate and generate revenues, it should start to pay back the loan principal and interest. Interest will be charged during the grace period

Interest Rate: Suggested interest rate **up to 8% per annum**. The Fund may offer lower interest rates in the first years, and increased rates for longer tenures, based on the business plan and bank partner agreement

Late Fee: In case instalments are not paid as defined in the loan agreement/ contract (past due), the entrepreneur will have to pay additional **late fees similar to the ones the partner bank charges**. Late fees would be charged to incentivise the social entrepreneur to pay back the loan as early as expected or to renegotiate the loan

Renegotiation: If the social business project **does not perform as expected**, the entrepreneur should contact the Technical Assistance Team to **renegotiate the loan contract**

Incubator: As a loan condition, entrepreneurs would be required to **attend training and present a complete and “investment-ready” business plan**. For the selected entrepreneurs and business plans, **technical support** will be provided during the incubation and launch of their business

ADMINISTRATIVE ARRANGEMENTS

This section analyses alternatives for the administrative arrangements to operationalise the Fund and recommends the alternative that best suits the local context.

The Social Business Fund will support social enterprises with loans (and a small portion in equities potentially) and technical support. However there are many different ways to lend funds to social entrepreneurs, such as:

- **Direct Contract**

In this model the Social Business Fund would work in a completely independent way, managing and operationalising all activities related to the “loans”, dealing directly with borrowers. Yunus Social Business Funds operate in a similar way.

As a non-financial institution in Timor-Leste, the Fund might not be allowed to offer and manage loans; in this case instead of loan contracts the Fund would negotiate contracts for exchange of fixed amounts in different periods of time.

- **Loan Guarantee Agreement**

Following the example of “Ontario Catapult Microloan Fund for Social Enterprises”, a financial institution partner would grant loans to social enterprises. The Social Business Fund would guarantee the loan principal amount (totally or partially), reducing (or eliminating in case of total guarantee) the financial institution’s credit risk. Loans would offer special conditions (interest rates, loan period, grace period, etc.) to be negotiated between the Social Business Fund and the financial institution.

In a loan guarantee agreement the soft loan would be offered and managed by the financial institution partner, while the Social Business Fund Technical Assistance Team would be responsible for selecting, improving and incubating the social business.

The characteristics of these two options are summarised on the next page.

ADMINISTRATIVE ARRANGEMENTS

	Direct Contract	Loan Guarantee
Scenario	Independent organization (similar to Yunus Social Business Funds)	Partnership with a FI. SBF would guarantee the loan (total or partial) principal amount
Credit Approval	Total flexibility to define criteria and select projects/entrepreneurs	If the SBF guarantees 100% of the loan amount, it can define the criteria for loan approval. If less than 100%, the FI may require additional collateral from the borrower
Credit Risk	Assumed by the SBF	Credit risk is assumed by the SBF in the guarantee proportion agreed
Capital Available for Loans	SBF Capital	SBF Capital / % of guarantee
Operation	Contracts of exchange fixed-amount with loan recipients	Standard loan contracts, managed by the FI
Loan Conditions (pricing, tenure, grace period)	Total flexibility to define loan conditions and pricing	Broader terms & conditions defined in the agreement between SBF and FI, based on the FI pricing/spread model
Loan Operation & Management	All activities performed by the Social Business team	Loan operations and management performed by the FI
Implementation	May require Central Bank approval & legal contracts	BNU and ANZ have done similar deals
Risks	High operational risk & credit risk	Credit risk & partner risk (delays, operation errors)
Cost	High fixed costs	Lower fixed costs
Key Challenges	Credit Risk Operational Complexity & Operational Risk – Social Business team would be required to also manage financial transactions	Credit Risk – Loan guarantee from a 3 rd party may reduce the borrower's commitment to pay back the loan. Prior experience between BNU and the World Bank (50% Loan Guarantee), resulted in 80% losses



ADMINISTRATIVE ARRANGEMENTS: RECOMMENDATION

Ideally the bank partner would create a specific loan for SMEs and offer it to entrepreneurs based on their potential to succeed and their social impact. A loan guarantee would incentivise the bank to further develop loan products to SMEs

Operating with **direct contracts**, the Fund would assume all activities related to the loan. It implies a highly complex operation, and consequently high costs, as well as a long-term commitment for the implementation (as it may require approvals from regulators). Also, the size of the Fund may not reach US\$10 million of capital in the near future (which was suggested by the Yunus Social Business Fund team as the required fund size to achieve financial sustainability). Hence, this alternative is not recommended.

In a **loan guarantee scheme**, the Fund would offer guarantees to the bank for all loans provided to selected social entrepreneurs, thus reducing the cost of loans to entrepreneurs. Loan guarantees are common practice in all banks, and easier and faster to implement. The total amount of loans would be limited by the guarantee ratio (initial conversations suggested 100% of the loan amount), and all credit losses would be deducted from the Fund. **A loan guarantee agreement is the recommended option to improve financing to SME.**

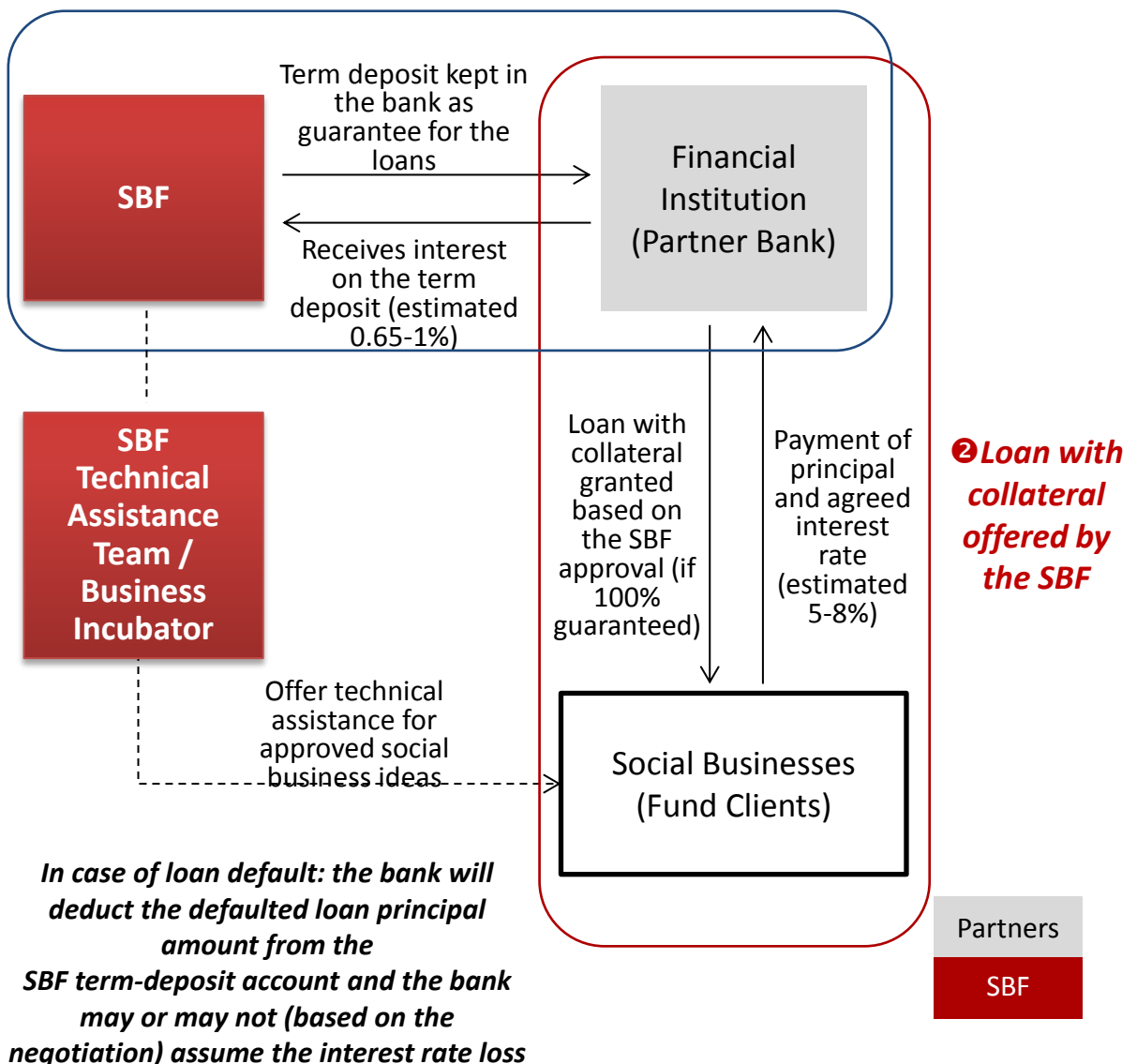
Business Incubator

The Fund would also set a business incubator providing **Technical Assistance** to entrepreneurs, for technical support and business guidance. Through the business incubator a technical assistance team would select business ideas and entrepreneurs, train and coach entrepreneurs to improve business plans, and offer consulting services for the first years of the social enterprise operation. Technical assistance would increase the chances of successful implementation of the selected business plans.

LOAN GUARANTEE: OPERATION

The Social Business Fund acts as a guarantor for the loans to selected social businesses, keeping a term-deposit account with the financial institution. This option is recommended for a small scale project (limited capital) as it allows **immediate implementation with reduced operational complexity**; but it compromises loan pricing, as it is defined by the bank

1 Standard term deposit, serving as loan guarantee

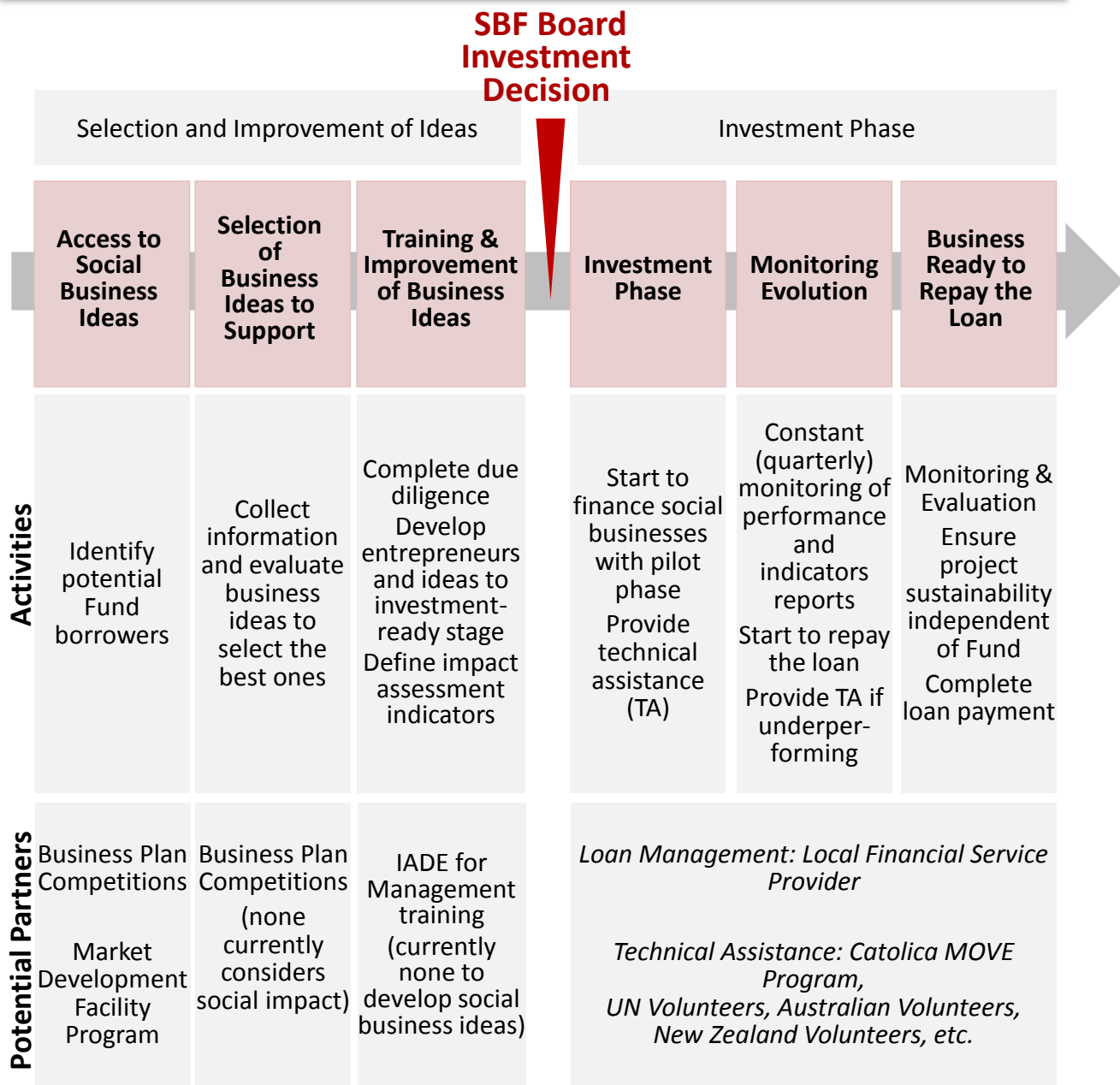


ROLES AND FUNCTIONS

<p>Financial Institution Partner</p>	<p>Responsible for the SBF loan operations, including: all loan transactions (payments, receivables, periods, charges, collection, recovery) and loan monitoring.</p> <p>Target clients, credit approval, interest rates, loan period, grace period, etc., will be based on the agreement negotiated. For loan guarantees the ratio for loans to be guaranteed would also be negotiated.</p>
<p>SBF Board</p>	<p>Formed by: UNDP, KOICA, MCIA, and representative of the partner bank. It can include major SBF donors and experts invited by other board members.</p> <p>It will be responsible for SBF key decisions, including: partner selection, Fund design, projects to support, resource mobilization strategy, etc.</p>
<p>Technical Assistance Team</p>	<p>This team of (social) business experts will be responsible for the overall management of the social businesses, including: initial selection of potential social business plans, social business plan enhancement, presentation of business ideas and plans to the SBF Board, support and monitoring of the investment and start up phases of the social businesses, projects’ monitoring and evaluation.</p> <p>The team will also be responsible for selecting and training national graduates to perform business consultancy services (supporting all Technical Assistance Team activities), and for capacity development of government agencies involved in the process, if necessary.</p> <p>The team will be managed by UNDP, initially. UNDP may identify other potential organizations to manage the team in the future.</p>
<p>Social Business Fund Clients</p>	<p>Entrepreneurs and social business plans selected to be supported by the fund. They will receive loans (at low interest rates) and technical assistance to improve their business skills, business plans, and to start/expand their social business. They will be requested to provide periodic updates/reports on their social business performance.</p> <p>Social Entrepreneurs can receive investments from other partners, but other loans should be further analysed, as it could increase the credit default rate of SBF loans (with lower interest rate, would not have incentives to paid first)</p>

ACTIVITIES & POTENTIAL PARTNERS: FUND OPERATION

As much as possible, the Fund should leverage activities that are already performed (partially or totally) by other organizations. Fund's operations should be coordinated by the Technical Assistance Team



Source: Adapted from YSBF website

3.4. SUSTAINABILITY STRATEGY

How to achieve long-term impact?

FUND SUSTAINABILITY STRATEGY

The Social Business Fund sustainability strategy is based on achieving a balanced “triple bottom line”, offering a differentiated service, with financial, social and environmental returns

In order to promote Social Businesses, the Fund should create social and economic value while promoting environmentally-conscious behaviour in all its activities. The table below defines guidelines to pursue each dimension of the “triple bottom line”.

Social Sustainability <i>People</i>	Economic Sustainability <i>Profit</i>	Environmental Sustainability <i>Planet</i>
<ul style="list-style-type: none"> • Ensure projects have a clear social motivation, creating significant social returns • Projects focus on overcoming poverty (helping the poor or underprivileged) • Mutually beneficial relationships with all stakeholders (employees, customers, suppliers, communities, etc.) • Good working conditions, with constant investments in capacity development 	<ul style="list-style-type: none"> • Ensure the Fund is resilient over time, operating with a small structure and aiming to cover its own cost • Support financially viable projects that offer innovative solutions with solid business models, aiming to zero credit losses • Efficient and transparent operations 	<ul style="list-style-type: none"> • Focus on minimizing the environmental impact from operation and supported projects • Evaluate the environmental impact of all supported projects • Support projects with focus on the environment

Source: <http://sustainabilityskills.net.au/what-is-sustainability/>

ECONOMIC SUSTAINABILITY

Ability to cover the Fund's operational costs by diversifying sources of income, minimizing risks and reducing costs

As a social initiative the Fund should not focus on profit maximization, but on promotion of social businesses as a tool to fight poverty. To guarantee the Fund's economic sustainability, it must generate sufficient income to cover administrative costs and potential credit losses.

Due to the limited fund size it may take a few years to achieve its economic sustainability.

Here are some suggestions to generate revenue, reduce losses, and increase capital:

Options for Revenue Generation & Loss Mitigation

- Strictly select projects that have a **clear and sustainable business model**
- **Cross-subsidize** projects with high social returns but lower financial returns with higher-return projects
- Charge **consultancy service fees** from mature projects that have already paid their loans but want to receive continuous technical support
- Support multiple projects in different areas to **diversify risk**
- Search for **additional investors or donors** to increase the Fund capital and scale
- **Minimize losses** – e.g., by offering emergency consultancy services to underperforming projects

Operational Efficiency & Cost Control

- Focus on developing **local staff** and recruiting **volunteers**
- Operate in compliance with defined standard operating procedures to ensure best use of available resources

4. FINAL RECOMMENDATIONS

FINAL RECOMMENDATIONS

- Focus on the selection of **financially viable business plans with high potential for social impact** – as this is the key differentiator of this Fund
- Negotiate a **partnership with a bank** willing to participate in the project as the financial service provider. Based on the supply analysis, most of the banks demonstrated interest in taking part in the project, but are not willing to share credit risk. Due to geographic presence and potential for scale-up, the **recommended options are BNCTL and BNU**
- A **loan guarantee agreement and technical assistance** would address the key concerns from entrepreneurs (demand analysis): high interest rates and business knowledge. A loan guarantee scheme optimizes the different expertise of the organizations involved
- Start with a **lean team (with volunteers)** supporting a **few viable business plans**; the success of the first months of the Fund would attract attention from potential partners and donors
- **Revise the name of the loans** – in focus groups, many participants were associating “Social Business Access to Finance” with “social-transfers” (social grants) and were expecting to receive grants, not loans
- Define strategies to **minimize wrong incentives**. Participants in focus groups advised us that offering guarantees for loans would incentivise borrowers to default (not to pay back), as borrowers would not suffer major consequences. BNU mentioned high credit losses in an experience with a loan-guarantee scheme with the World Bank
- Maintain constant **focus on resource mobilization**, to increase the current capital available for the Fund establishment and for any technical assistance cost
- Avoid duplicating activities through **partnerships with organizations that are already operating in the field** (e.g., IADE for the business plan selection); work together to improve the quality of services provided

NEXT STEPS

Next steps to implement the Social Business Fund based on the final recommendations are:

- Define the **key partnerships** (bank partner, other donors, technical assistance, etc.) and agree on the Fund format (objectives, type of support, and roles)
- Obtain **legal advice** on the requirements for the legal format of the Social Business Fund, based on the definition of partners and type of support. Examples of questions to address:
 - Can the fund accept shares from social businesses as collateral for loan?
 - Is it possible to have different loan interests for each period/year?
 - Loan or Loan + Equity
 - ...
- Negotiate the **agreements and contracts** with partners
- Obtain **necessary approvals** (e.g., from the Central Bank, Ministry of Justice, etc.)
- **Fine-tune the standard operating procedures** and keep them adjusted and updated
- Start **operation** based on the standard operating procedures

